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August 8, 2007

Marlene Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

RE: *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, RM-10593

Dear Ms. Dortch:

Enclosed for electronic filing in the above referenced proceedings is the **REDACTED** version of the Supplemental Comments of AT&T Inc.

Please contact me with any questions.

Respectfully submitted,

/s/ Christopher T. Shenk

cc: Margaret Dailey (Margaret.dailey.fcc.gov)
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
	)	
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593

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August 8, 2007

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SUPPLEMENTAL COMMENTS OF AT&T INC.

Pursuant to the Commission's *Notice*,[1] AT&T Inc. ("AT&T") respectfully submits these supplemental comments.

INTRODUCTION AND SUMMARY

It has been nearly two decades since the Commission first recognized competition in the provision of special access services and began the process of gradually deregulating those services. Judged by any meaningful metric, the Commission's deregulatory special access reforms have been a notable success. They have fostered a dynamic competitive environment characterized by declining prices and a growing array of competitive options for purchasers of special access services. Today, special access services are priced at their lowest levels ever and customers have more choices in prices, terms and conditions, suppliers, services, and even technologies than they have ever had.

To be sure, purchasers of special access services would love nothing more than for the FCC to mandate further price reductions, and they have been beating the bushes in Washington

[1] Public Notice, *Parties Asked To Refresh Record in the Special Access Notice Of Proposed Rulemaking,* WC Docket No. 05-25, RM-10593 (released July 9, 2007) ("*Notice*").

to that end. What business, after all, would not welcome mandated reductions in the costs of its inputs? The facts, however, make clear that there is no basis for turning back the clock and re-regulating special access services. To the contrary, as AT&T and other commenters demonstrated in the first phase of this proceeding in 2005, the special access marketplace has, for years, exhibited falling prices, rising output, rapid innovation, and robust and growing facilities-based entry and competition. Moreover, those trends have continued during the past two years, despite the dire predictions to the contrary by proponents of special access re-regulation.

Indeed, these trends have, if anything, accelerated during the past two years. The prices AT&T's customers pay for even the lowest capacity DS1 services, which proponents of increased regulation contend face the least competition, continue to fall. At the same time, through both internal growth and consolidation, the scores of traditional CLEC suppliers of competitive special access services have significantly expanded their reach and competitive activity. Thus, even more so today than in 2005, the CLEC fiber that blankets the downtown areas and other commercial centers where special access demand is heavily concentrated is already connected to or very near the buildings that account for the bulk of AT&T's special access demand. These facts alone establish that the Commission's deregulatory policies are working and that special access is a marketplace that needs *less* regulation, not more.

The last two years, however, have seen far more than a continuation of the falling prices and widespread and increasing *intra*modal competition that AT&T and others documented in previously-filed comments and reply comments. In addition, the promise of *inter*modal competition has now indisputably been realized. Intermodal broadband technologies that were merely promising two years ago have now been widely deployed with great commercial success. As detailed below, there are now economic alternatives to price cap LEC special access services

not only throughout the dense commercial areas that include the vast majority of special access demand – and hence where CLECs have traditionally focused their investments – but also at lower demand locations outside commercial centers. Indeed, intermodal broadband wireless and cable providers are specifically targeting DS1 and DS3 demand at cell towers and other remote locations. And rapidly increasing backhaul needs of mobile wireless providers that increasingly provide data, video and other broadband applications give cable, fixed wireless and traditional wireline providers still greater incentives to compete aggressively to serve customers outside core commercial centers.

All of the major cable operators have substantially intensified their marketing of DS1, DS3 and higher capacity services outside (and inside) commercial centers in the past two years. Even more fundamentally, broadband wireless special access services are now being aggressively and successfully marketed across the nation by numerous providers that can deploy DSn-level services to virtually any location at competitive prices and in a fraction of the time required to deploy wireline facilities. AT&T Mobility already purchases thousands of DS1 circuits from fixed wireless providers to serve its backhaul needs outside AT&T's incumbent LEC service territory. AT&T's special access customers are likewise making extensive use of these broadband wireless alternatives, and using the existence of these (and other) alternatives to demand price reductions and service improvements from AT&T. Both Sprint and T-Mobile, for example, have repeatedly stressed to AT&T their intermodal options for cell towers with DS1-level demand and made clear that they will move their business elsewhere if AT&T does not agree to terms that they find satisfactory. This is vivid confirmation that an intensely competitive marketplace is now operating at virtually all levels of demand nearly everywhere.

These latest intervening developments in intermodal competition have eliminated the entire premise underlying the claims of proponents of re-regulation that customers lack comparable alternatives. The only sensible response to these developments is to further deregulate special access services. The Commission should recognize that the ability to offer heavily discounted contract arrangements can only benefit consumers and grant price cap LECs Phase I pricing flexibility to meet competition for all services everywhere. In addition, the Commission should completely deregulate OCn-level and packet-based special access services in light of the uncontested evidence that those services are being competitively supplied everywhere. And, because there now are alternatives to all price cap LEC special access services, including outside the commercial centers areas where CLEC facilities are most prevalent, the Commission should grant price cap LECs significantly broader pricing flexibility for DSn-level services. At a minimum, the Commission should address the under-inclusiveness of its pricing flexibility triggers by allowing LECs to count towards the triggers any wire center that is shown to contain active facilities-based competitors even if competitors have chosen to collocate in the LEC central office (and instead use intermodal facilities and carrier hotels). That will put an end to the absurdity that has prevented AT&T from obtaining full Phase II pricing flexibility in such hotbeds of competitive activity as Chicago, Dallas, Houston, Detroit, San Francisco-Oakland, San Diego, and St. Louis – respectively, the 3rd, 5th, 8th, 9th, 12th, 17th and 18th largest MSAs in the country.

At the same time, the Commission should summarily dismiss proposals that it jettison the incrementally deregulatory policies that it has pursued for nearly two decades by (1) eliminating or reducing the availability of Phase II pricing flexibility and (2) readopting the equivalent of rate of return regulation by using a cost of service analysis to "reinitialize" price caps, subject to

increased "X" and "g" factors. While such measures would have been flatly inappropriate even under the known facts of two years ago, they would be the height of arbitrariness in today's marketplace. The Commission long ago abandoned cost of service regulation as incompatible with and too rigid even for markets with only limited competition. Returning to such a regime now, or recalibrating price cap indices based on rate of return premises, would turn sixteen years of regulatory policy on its head. It would destroy the efficiency incentives of price cap regulation, punish price cap LECs for acting on the pro-competitive incentives price cap regulation was designed to create, and embroil the industry in extraordinarily costly and protracted proceedings that past experience shows would create debilitating uncertainty and chill investment by all industry participants to the detriment of all consumers. Worse yet, as the questions posed in the *Notice* only highlight, it would raise all of the same difficulties the industry, regulators and the courts experienced the last time the Commission experimented with cost modeling, *i.e.*, arbitrary and deeply flawed results spawning years of litigation that yielded only deepening uncertainty. The Commission itself has recognized these consequences, observing: "the TELRIC rules have proven to take a great deal of time and effort to implement, and have been the subject of extensive criticism."[2] It is likewise worth remembering the sordid history of the Commission's past attempts to estimate and sustain a productivity "X factor" – an endless series of protracted regulatory proceedings and judicial reversals that the Commission was able to end only with the industry compromise that proponents of re-regulation now ask the Commission to unravel.

[2] Notice of Proposed Rulemaking, *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, 18 FCC Rcd 20265, ¶ 5 (2003) ("*TELRIC NPRM*").

Re-regulation would be particularly arbitrary and capricious given the unfortunate reality, highlighted by the Government Accountability Office ("GAO") in its recent special access report, that competitive special access providers and large special access customers have uniformly refused to provide the Commission with any real data about the true extent of their competitive facilities, service offerings and market successes (in the case of suppliers) or the alternative facilities and services that are available to them (in the case of purchasers). Although the incomplete information available to AT&T and others that have heeded the Commission's instruction to support their advocacy with actual evidence of the extent of facilities-based competition is more than sufficient to reject proposals for increased regulation and to justify additional deregulatory reforms, the Commission plainly could not defend an order that reduced rates by regulatory fiat on a record that fails to include full information on the availability of alternative facilities.

The remainder of these comments is organized as follows. Part I discusses the developments in the marketplace during the past two years that establish the need for further deregulation of special access services. Part II demonstrates that these developments require the retention and substantial expansion of Phase II pricing flexibility and foreclose the proposals to eliminate or reduce pricing flexibility or to reinitialize price caps and subject them to increased "X" or "g" factors. Part III specifically addresses the other questions raised in the *Notice.*

ARGUMENT

I. MARKETPLACE DEVELOPMENTS IN THE PAST TWO YEARS ESTABLISH BEYOND DOUBT THAT THE COMMISSION SHOULD EXPAND, NOT CONTRACT, THE PRICING FLEXIBILITY IT AUTHORIZED IN 1999.

The primary factual issue in this proceeding is ultimately straightforward. Is today's special access marketplace characterized by the kind of fundamental market failure that would justify the reintroduction of the onerous regulation of special access rates that the Commission

abandoned years ago, but that have been urged by the proponents of re-regulation? Or is it a market in which competition is substantial and rapidly growing, in which customers are receiving lower prices and better service each year, and in which the best way to promote the public interest is to reduce regulation? Although AT&T's submissions and analyses have necessarily been limited to its own internal data and publicly available information, AT&T provided extensive evidence on these points in its previously-filed comments and reply comments, describing both the competitive alternatives that are known to it and the price reductions and service improvements that it has been compelled to offer to meet the rapidly growing actual and potential competition. AT&T is pleased to have the opportunity to update these showings to account for the dramatic developments of the past two years, and to create a record that overwhelmingly demonstrates that special access is a marketplace that requires less regulation, not more.

Despite the absence of critical information that, as described below, competitors could choose to supply regarding their extensive fiber deployment and success in providing alternative access, the record here abundantly establishes the need for further deregulation, for the events of the past two years have dramatically confirmed the showings and predictions that were made in AT&T's previously-filed comments and reply comments, and they have dramatically repudiated the claims and predictions of those favoring re-regulation. As demonstrated in Part I.A, special access competition has intensified in the past two years. Traditional CLECs have become stronger and more effective. Cable companies have moved even more aggressively to provide alternative DSn-level services outside (as well as inside) the areas served by traditional CLECs. And whereas wireless alternatives were only just emerging two years ago, they now have been commercially deployed on a widespread basis and embraced by customers throughout the nation.

AT&T, Sprint, and other cellular carriers, for example, are now obtaining thousands of DS1 circuits in remote locations and elsewhere from wireless broadband providers.

As demonstrated in Part I.B, in the last two years AT&T's customers have continued to receive ever greater benefits from the competition and investment spurred by the Commission's deregulatory policies. Because of this growing competition, the prices paid by AT&T's customers have continued to fall in the past two years and AT&T has continued to invest in its network and to expand and improve its service offerings, confirming that AT&T has used the pricing flexibility that it has obtained to better meet its customers' individual and evolving needs.

A. Special Access Competition Has Greatly Intensified In the Past Two Years.

AT&T demonstrated in 2005 that it then faced substantial and growing actual and potential special access competition.[3] First, it showed that it faced vigorous competition from traditional CLECs in areas that contain the vast majority of AT&T's special access demand. AT&T demonstrated that CLECs are intense competitors in the provision of OCn level services everywhere, that they were capable of serving the majority of AT&T's demand for DS1 and DS3 level services, and that they constrain AT&T's prices even in areas where they have not yet deployed facilities.[4] Second, AT&T showed that cable service operators provide alternatives to AT&T's services in remote and less dense areas that traditional CLECs' networks do not yet reach (as well as in the dense areas that they do), and, indeed, that cable service operators accounted for **[BEGIN CONFIDENTIAL INFORMATION]** **[END**

[3] SBC Opening Comments, WC Docket No. 05-25, at 10-24 (filed June 13, 2005); SBC Reply Comments, WC Docket No. 05-25, at 10-15 (filed July 29, 2005); Declaration of Parley Casto on Behalf of SBC Communications Inc., WC Docket No. 05-25, ¶¶ 11-75 (filed with SBC Opening Comments as Att. A, June 13, 2005) ("Casto Initial Decl."); Reply Declaration of Parley Casto on Behalf of SBC Communications Inc., WC Docket No. 05-25, ¶¶ 11-72 (filed with SBC Reply Comments as Att. B, July 29, 2005) ("Casto Reply Decl.").

[4] SBC Opening Comments, at 10-16; Casto Initial Decl. ¶¶ 12-35.

CONFIDENTIAL INFORMATION] of AT&T's retail DS1 special access line losses.[5] Third, while broadband wireless services were not then being significantly used on a widespread basis, AT&T predicted that they soon would be and would pose an "even greater competitive threat" than cable given the costs of the facilities, their capabilities, and the speed with which they can be deployed.[6]

Over the past two years, the competition provided by each of these alternatives has intensified or, in the case of broadband wireless, has been realized on a large scale for the first time. While competition has increased everywhere, the most dramatic intervening developments have occurred in more remote areas where traditional CLECs have deployed fewer facilities. Those areas have been aggressively targeted by cable operators and wireless broadband providers, largely in response to skyrocketing demand from wireless carriers for special access facilities to serve cell sites located in those areas. As a result, alternative special access facilities have been broadly deployed in these (and other) areas and are extensively used by cellular carriers and other special access customers for DS1 and higher capacity services. In fact, AT&T Mobility now purchases more than **[BEGIN CONFIDENTIAL INFORMATION]**

[END CONFIDENTIAL INFORMATION] from alternative (non-ILEC) providers of special access backhaul services.[7]

Traditional CLECs. Traditional CLECs are the providers of alternative special access services that were well established when the *Pricing Flexibility Order*[8] was adopted and that are

[5] SBC Opening Comments, at 17-18; Casto Initial Decl. ¶¶ 37-43.

[6] SBC Opening Comments, at 18-20; Casto Initial Decl. ¶¶ 44-53.

[7] Casto Supp. Decl. ¶ 50, attached hereto.

[8] Fifth Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers; Petition of U S*

most likely to be captured by the existing collocation-based special access pricing flexibility triggers. They operate in metropolitan areas of all sizes, where they have deployed fiber networks that essentially blanket the areas in which the demand for special access services is concentrated. They provide wholesale and retail customers with alternative OCn, DS3, and DS1 level special access services over these facilities (or in some cases in combination with AT&T facilities purchased as UNEs or special access).[9]

As explained in detail in the attached Supplemental Declaration of Parley Casto, Assistant Vice President, Strategic Pricing for AT&T's Business Marketing ("Casto Supp. Decl."), CLECs have become even more effective competitors in the past two years. During this period, CLECs have expanded their networks by internal growth and by merger, allowing them to continue to competitively supply new OCn level services everywhere.[10] Their ability to supplant AT&T and to serve AT&T customers with DS1 and DS3 level demand has expanded as well.[11] In 2005, AT&T analyzed the proximity of known CLEC fiber to AT&T's DS1 and DS3 demand in 10 MSAs in the 13-state SBC region. The Supplemental Casto Declaration provides information on 5 additional MSAs, the two BellSouth Phase II channel termination MSAs examined by the GAO in its recent report (Atlanta and Miami) and three smaller Tier II MSAs in the 13-state SBC region (Austin, Columbus, and San Jose). As explained therein, **[BEGIN CONFIDENTIAL INFORMATION]** **[END CONFIDENTIAL**

West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA, 14 FCC Rcd. 14221 (1999) ("*Pricing Flexibility Order*").

[9] *See, e.g.*, Time Warner Telecom, Annual 10-K Report, at 3 (March 2006) (TWT is the "leading provider" of metro area broadband optical networks in "44 major U.S. markets"); Level 3 Web Page, available at http://search.level3.com/561.html (Level 3 is "an undisputed expert in off-net lateral construction").

[10] Casto Supp. Decl. ¶ 6, n.2 & ¶ 7.

[11] *Id.* ¶¶ 10-21.

INFORMATION] of AT&T's demand for both DS1 and DS3 services in those MSAs is either already connected to or within 1000 feet (or about three blocks) of known CLEC facilities.[12] But, as Mr. Casto explains, because the CLEC fiber data available to AT&T is far from complete, this vastly understates the ability of AT&T's customers to obtain competitive special access services from even traditional wireline CLECs.[13] In any event, because neither AT&T nor any other price cap LEC does (or feasibly could) price its special access services on a building-by-building basis, the extensive facilities-based competition from CLECs constrains AT&T's pricing of DSn level facilities outside as well as inside the specific areas that are covered today by the CLECs' networks.[14]

It should come as no surprise therefore that a 2007 analyst report assessing wholesale private line services states that, on a scale of 1 to 10, "the degree of competition is expected to be 9."[15] The report explains that "[e]ven though the private line market has been witnessing consolidation during the last three years, the number of competitors [about 45] still continues to be high."[16] In addition to the large number of CLECs' offering traditional TDM special access services, the report also correctly notes "stiff competition" from other wireline technologies, including Ethernet-based and Wavelength services.[17]

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[12] *Id.* ¶¶ 10, 12.

[13] *Id.* ¶¶ 11, 20-21.

[14] *Id.* ¶ 21.

[15] Frost & Sullivan, *North American Wholesale Private Line Services Markets*, at 1-11 (2007) ("*Frost & Sullivan Report*"); *see also id.* at 1-28 ("With over 45 competitors, the degree of competition within the wholesale private line market is highly intense. The local access market has a degree of competition which is even more intense. That market is dominated by small, medium and large sized players").

[16] *See Frost & Sullivan Report* at 1-11.

[17] *Id.*

Further, CLECs have also become stronger competitors through mergers and consolidations. During the past two years, numerous CLEC competitors expanded their reach and strengthened their financial and competitive positions through CLEC-CLEC mergers and consolidation.[18] And in the past two years, virtually all CLECs have further expanded their networks through ordinary internal growth – adding thousands of fiber miles and new building connections as they have attracted additional customers and built out their networks further in order to serve them.[19]

The Explosion Of Intermodal Cable and Wireless Alternatives Outside the Commercial Centers That Are Hotbeds Of Traditional CLEC Activity. In their 2005 filings, the proponents of special access re-regulation did not question that CLECs compete intensely for OCn level services everywhere and that they provide potent competition for DSn level services in buildings close to their networks. Rather, their primary argument was that while CLECs' networks are already connected to or very close to buildings that contain most DSn-level demand, there is some DSn-level demand that exists outside the commercial centers where traditional CLEC networks are most prevalent. They alleged that there was no substantial competition, and no constraints on the pricing of incumbents, in these areas of Phase II (and

[18] Casto Supp. Decl. ¶¶ 14-19. The AT&T-SBC, AT&T-BellSouth, and Verizon-MCI mergers were conditioned on the divestiture of fiber connections to all of the commercial buildings formerly served only by the merging parties that were deemed unlikely candidates for additional competitive special access connections, so they had no adverse effect on competition and in fact enabled a number of individual CLECs to expand their networks by purchasing the facilities that AT&T and Verizon were required to divest. Level 3, for example, further expanded its network by 1,600 miles of metropolitan fiber with connections to 200 buildings with facilities divested by AT&T and purchased by Level 3 in connection with the AT&T/SBC merger. *See id.* ¶ 14.

[19] *Id.* ¶¶ 14-19. XO, for example, has continued to grow its wireline fiber network and has engaged in a "significant expansion in the availability of XO Ethernet services," such that it can now provide such services in more than 60 metropolitan markets. Press Release, XO Communications Expands National Ethernet Services Footprint (Mar. 20, 2006), available at www.xo.com/news/293.html.

price capped) MSAs. In this regard, the proponents of special access re-regulation focused on large businesses with some locations outside commercial centers and on the cellular carriers who have extensively deployed radio tower facilities outside commercial areas that require dedicated special access facilities – referred to as "backhaul" facilities – to connect the remotely-located towers to switches. Because traditional CLECs had not deployed fiber as extensively in these areas and because cellular carriers and remote satellite offices historically often needed only low capacity DS1-level connections, proponents of re-regulation asserted that these customers here had no alternative to the price cap LECs' special access facilities.

These allegations did not withstand scrutiny even two years ago. As a preliminary matter, irrespective of whether existing CLEC facilities connect to remotely located wireless cell towers and other sites in wire centers with relatively low demand for special access services, it is simply untrue that CLECs do not constrain AT&T's pricing of circuits outside the areas of an MSA that are currently served by CLEC fiber. AT&T's tariffed prices are the same throughout broad density zones in each MSA and do not vary between individual customer locations that currently are served by CLEC fiber and those that are not.[20] Consequently, the price-constraining effects of the robust competition for special access services that already exists in those areas in which special access demand is concentrated are felt in more remote areas with lower demand for such services. In any event, even if CLECs have not yet extended their fiber networks to such areas, that does not mean those areas are bereft of competitive alternatives. As AT&T explained in 2005, these are among the areas in which ILECs are currently required to provide UNE loops and transport at below cost TELRIC rates.[21] More fundamentally, as AT&T also demonstrated in 2005, intermodal competition directly constrains its pricing of DS1 and

[20] *See* Casto Supp. Decl. ¶ 21.

[21] *See* SBC Opening Comments at 23-24; Casto Supp. Decl. ¶ 13.

DS3 services in the less dense areas that traditional CLECs do not currently reach. Two years ago, cable operators already were marketing DSn-level services to business customers in these (and other) areas, and the imminent prospect of wireless broadband alternatives for DS1 and higher capacity services further constrained AT&T's pricing.[22]

But whatever the state of affairs two years ago, intervening developments have established that the factual premise of the claim of the re-regulation proponents is patently false. In the last two years, the previously-predicted broadband wireless competition has in fact developed on a large scale, and these intermodal competitors now provide DS1 and higher capacity services widely in remote and dense areas alike. Beyond that, cable competition has greatly intensified during the past two years.

These developments have been precipitated, in substantial part, by the explosion in demand from wireless carriers. As the *Notice* recognizes, wireless networks no longer carry only voice services, but now also carry Internet, music, video and myriad other entertainment and data services, and wireless carriers are significantly upgrading their facilities to "3G", "3.5G" and "4G" networks. Consequently, the amount of voice and data traffic that must be carried over cellular "backhaul" facilities has increased dramatically over the past two years, with cellular carriers now requiring DS3s or many multiples of DS1s for backhaul connections that formerly required only one or two DS1s. It is widely recognized that capacity requirements for backhaul facilities will increase far more in the future, attracting greatly increased investment and activity.[23] As Cox reports, "the capacity they [wireless telephone carriers] are needing now . . . are T-3s or multiple T-3s . . . [and] when you are talking about that kind of capacity, the financial

[22] *See* Casto Initial Decl. ¶¶ 37-54.

[23] Casto Supp. Decl. ¶¶ 40, 42.

model has been able to prove in."[24] Indeed, whereas the cellular backhaul had been a $2-3 billion market,[25] some predict it will mushroom into a $31 billion special access opportunity during the next few years.[26]

These developments have contributed to the widespread successful introduction of wireless broadband services in the last two years and to the decisions of cable operators to intensify their efforts in this competitive space.[27] Alternative providers are thus able to justify even more broad deployment of facilities to meet this increasing demand and, as detailed below, they are competing aggressively today even to serve the diminishing number of cell sites that still require only DS1-level connections.

Fixed Wireless. AT&T's filings in 2005 acknowledged that broadband fixed wireless was "still in its early stages" and was not then being commercially provided on a widespread basis.[28] But AT&T stated that the next generation of fixed wireless providers "pose an even greater competitive threat" to incumbents than does cable[29] and are uniquely equipped to provide DS1 as well as higher capacity services in the "high cost wire centers that most concern the Commission."[30] Broadband wireless can provide highly reliable, economically-priced special access services with installation in a fraction of the time it takes to install wireline services.

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[24] Karen Brown, "A Towering Opportunity?", CedMagazine.com, Sep. 1, 2005, http://www.cedmagazine.com/article.aspx?id=67126 (quoting Amy Enoch, Vice President of carrier and national accounts, Cox Business Services).

[25] Lynette Luna, "Getting Back Backhaul Costs," Tellabs, at 1 (Winter 2005-2006), available at www.tellabs.com/news/reprints/backhaul_winter05-reprint.pdf.

[26] *See, e.g., id.*

[27] Casto Supp. Decl. ¶¶ 45-51.

[28] SBC Opening Comments at 20.

[29] *Id.* at 18.

[30] *Id.* at 20.

Because broadband wireless technologies require installation only of a relatively small device in a window or on the roof of a building, the technology allows DS1-equivalent service to be provisioned in 24 to 48 hours; it can provide transmission speeds of DS3 or higher, and the facilities costs per transmission mile can be very low. Fixed wireless services also are flexible; they can be installed on a temporary basis and bandwidth can be scaled with demand. In addition, prior limitations to fixed wireless, such as distance and line of sight, are being overcome by new technologies such as WiMAX, which does not require clear lines of sight and has a potential coverage area that spans 30 miles with little regard to topography.

As explained in detail in the Casto Supplemental Declaration, the promise of fixed wireless is now being realized on a substantial scale. Numerous firms have deployed facilities and are offering services in each of the nation's largest markets, and there are many other local and regional fixed wireless providers.[31] These firms are growing rapidly and signing up new customers every day.[32] These new customers include, among others, AT&T Mobility, which (especially in the past two years) has determined that fixed wireless services are a viable and cost-effective way of obtaining connections to its cell sites. AT&T Mobility has already purchased **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** outside the territories in which AT&T is the incumbent LEC.[33]

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[31] Casto Supp. Decl. ¶¶ 23-29.

[32] *Id*. For example, XO, in partnership with its affiliate Nextlink, just in July "announced expansion of its fixed broadband wireless services into 24 new markets," including large cites like Philadelphia, Boston, and Denver as well as smaller markets like Akron, Sacramento, and Wilmington. Carol Wilson, "XO Expands Broadband Wireless to 36 Markets," Telephony Online (July 11, 2007), available at http://telephonyonline.com/broadband/marketing/xo_broadband_wireless_071107.

[33] Casto Supp. Decl. ¶¶ 49-50.

Other wireless carriers have reached the same conclusions, and they too are obtaining wireless DS1 services from broadband wireless providers. Indeed, in contrast to its statements to regulators and legislators, Sprint pointedly informed AT&T during recent contract negotiations that **[BEGIN CONFIDENTIAL INFORMATION]**

[END CONFIDENTIAL INFORMATION] that it now obtains from AT&T in some markets.[34] These are not empty threats: wireless backhaul specialist FiberTower (an important supplier to AT&T Mobility) recently announced "that it had entered into a agreement with Sprint Nextel . . . to provide backhaul services in seven of the wireless carrier's initial WiMax launch markets."[35] Likewise, AT&T's research indicates that Verizon Wireless already uses competitively-supplied broadband wireless facilities at a substantial percentage of its cell sites in states within AT&T's incumbent LEC footprint.[36] In addition, T-Mobile purchases a large number of backhaul circuits in a variety of cities from FiberTower; earlier this year, for example, **[BEGIN CONFIDENTIAL INFORMATION]**

[END CONFIDENTIAL INFORMATION][37]

Broadband wireless thus has unquestionably arrived as a potent alternative to incumbent LECs' DS1 and higher capacity special access services that are available outside (and inside) the commercial centers most heavily served by traditional CLECs. Moreover, broadband wireless is

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[34] *Id.* ¶ 56.

[35] Press Release, FiberTower Announces Backhaul Agreement With Sprint Nextel for WiMax Buildout (Aug. 6, 2007), available at http://www.bbwexchange.com/pubs/2007/08/06/page1423-647177.asp.

[36] Casto Supp. Decl. ¶ 45.

[37] *Id.* ¶ 48.

certain to be a major competitive force for many years to come, particularly outside areas served by traditional wireline CLECs, and the development of this alternative has itself made it quite clear that the factual premise of the claim of the re-regulation proponents is false.

Cable Providers. Cable companies were providing intermodal alternatives to ILEC special access services two years ago. At that time, the evidence showed that cable networks passed more than three million small and medium-sized businesses with two-way hybrid fiber-coaxial cable facilities that are fully capable of providing business class service at DSn (and often higher) speeds.[38] Even two years ago, cable had widespread infrastructure in business districts, which easily could be used to provide high-capacity dedicated telecommunications services to many commercial buildings.[39] And, it was already the case two years ago that **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** of the retail DS1 circuits AT&T lost to competitors were due to cable service providers.[40]

As explained in detail in the Casto Supplemental Declaration, the competition provided by cable operators has dramatically intensified over the past two years. As noted above, the fact that cellular carriers are demanding increasingly higher capacity circuits to meet their backhaul needs has caused numerous cable operators to move aggressively to seek this and other special access business. The increased activity by cable operators is reflected in the public data about them. For example, Cox now serves more than 100,000 businesses in more than 30 markets, from California to New England, and Cox is continually expanding its service offerings to enter

[38] Casto Initial Decl. ¶ 37.

[39] *Id.*

[40] *Id.*

new markets.[41] Time Warner Cable now serves 245,000 commercial high-speed data subscribers.[42] CableVision is aggressively marketing business services through its Optimum Lightpath subsidiary, with a network of 2,500 route miles serving over 2,000 commercial buildings in New York, New Jersey and Connecticut.[43] It now offers a variety of Ethernet-based voice, data and internet services including high-bandwidth point-to-point, hub-and-spoke, and multipoint-to-multipoint services, and has achieved significant market penetration in the New York area.[44] And Comcast has announced that "offering services geared to small and midsize businesses will be its *top* new priority of 2007 and 2008."[45] Because Comcast provides service in 41 states, including 22 of the 25 top U.S. markets, its plans to compete more aggressively for customers in the small and midsize business market pose an additional, significant threat to the special access business of ILECs such as AT&T.[46]

AT&T has felt the effects of the more aggressive cable competition. In the areas where AT&T is the incumbent LEC, AT&T has continued to incur significant competitive losses to cable operators in the past two years.[47] For example, Verizon Wireless has told AT&T that

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[41] *See* Cox Business Services – A Quick Overview, http://www.coxbusiness.com/aboutus/index.html; *see also* Casto Supp. Decl. ¶¶ 32-33.

[42] *See* Time Warner Cable, Annual 10-K Report, at 12 (March 2006); *see also* Casto Supp. Decl. ¶ 36.

[43] *See* About Optimum Lightpath, http://www.optimumlightpath.com/printpage7.html; *see also* Sterling Perrin, *Cable vs. Telcos: The Battle for the Enterprise Market*, Heavy Reading, at 12 (Feb. 2006) ("*Heavy Reading*"); *see also* Casto Supp. Decl. ¶ 34.

[44] *See* About Optimum Lightpath, http://www.optimumlightpath.com/printpage7.html

[45] *See* Peter Grant, *Cable Firms Woo Business In Fight for Telecom Turf*, The Wall Street Journal Online (Jan. 18, 2007), available at http://startup.wsj.com/runbusiness/relationships/20070118-grant.html?refresh=on (emphasis added).

[46] *Id.*

[47] Casto Supp. Decl. ¶ 51.

[48] **[END CONFIDENTIAL INFORMATION]** Verizon Wireless is also **[BEGIN CONFIDENTIAL INFORMATION]**

[49] **[END CONFIDENTIAL INFORMATION]** Many other losses have been threatened. For example, T-Mobile **[BEGIN CONFIDENTIAL INFORMATION]**

[END CONFIDENTIAL INFORMATION][50] And Sprint has threatened to **[BEGIN CONFIDENTIAL INFORMATION]**

[51] **[END CONFIDENTIAL INFORMATION]**

As a purchaser of special access, AT&T has also obtained benefits from this increased competition. For example, in areas where AT&T is not the incumbent LEC, AT&T Mobility has taken advantage of the increased competition offered by cable operators and now purchases DSn-level "backhaul" circuits from cable operators in a number of markets outside its incumbent LEC footprint.[52]

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[48] *Id.* ¶ 45.

[49] *Id.*

[50] *Id.* ¶ 48. **[BEGIN CONFIDENTIAL INFORMATION]** **[END CONFIDENTIAL INFORMATION]**

[51] *Id.* ¶ 46.

[52] *Id.* ¶¶ 49-50.

Many industry analysts believe that cable companies and broadband wireless providers have inherent advantages over incumbent LECs in providing backhaul services to wireless carriers. Price cap LECs' fiber networks tend to be concentrated in the urban areas where special access demand is most concentrated, and they often lack fiber facilities in the residential and less densely populated areas where a large portion of the cell sites are located.[53] By contrast, broadband wireless providers can deploy service virtually anywhere. Cable companies have extensive fiber networks not only in the downtown urban areas where most LEC fiber is deployed but also outside of those areas, in the suburban and more rural areas where a large portion of cell sites are located. As a result, cable companies and broadband wireless providers often already have fiber facilities nearer to cell towers than the telephone companies currently have and that capacity can be, and is, used to provide backhaul services.[54]

But whether or not incumbent LECs face inherent disadvantages, there is no doubt that today wireless carriers and other customers have competitive alternatives to the special access services of incumbent LECs not only in the dense areas blanketed by networks of CLECs but also in the remote and higher cost areas.

B. In The Past Two Years, Special Access Providers Have Responded To Increasing Competition By Further Reducing Prices And Introducing New And Innovative Services.

Perhaps the most definitive proof that competition for special access has intensified in the past two years is the behavior of AT&T and other incumbent special access providers. During this period, competitive pressures have forced them to lower prices, offer innovative new

[53] *Id.* ¶ 44.

[54] *See, e.g.*, Matt Stump, *Cable Could Haul Wireless Calls*, Multichannel News (May 15, 2006) (cable companies have "far more fiber and coaxial cable near cell towers than the telephone companies currently have" and that capacity can and is used to provide backhaul services), available at http://www.multichannel.com/article/CA6334344.html.

services, features and terms and make substantial investments in their networks to improve service quality and better meet unique or individualized customer needs – a fact that competitive providers have recently acknowledged to their investors.[55]

AT&T showed in 2005 that the prices customers paid for DS1 and DS3 special access circuits in MSAs in SBC's 13-state region where it had obtained Phase II pricing flexibility – *i.e.*, the amounts that include the discounts actually obtained by AT&T's customers in those areas – decreased from 2001 through 2004. Since then the average prices in the 13-state region reported in 2005 have continued to fall dramatically for both DS1 and DS3 circuits. The average price per unit AT&T received for the DS1 special access circuits that re-regulation proponents have labeled the least competitive services declined in nominal dollars by **[BEGIN CONFIDENTIAL INFORMATION]**

[END CONFIDENTIAL INFORMATION] in real, inflation-adjusted dollars[56] – before the substantial additional reductions AT&T implemented in the second quarter of 2007 pursuant to its AT&T-BellSouth merger commitments. During the same period, average per unit prices for DS3 services declined by **[BEGIN CONFIDENTIAL INFORMATION]**

[END CONFIDENTIAL INFORMATION]. These facts are consistent with the GAO finding that DSn-level prices in pricing flexibility areas have decreased significantly

[55] *See, e.g.*, Time Warner Telecom, Annual 10-K Report, at 13 (March 2006) ("We believe that ILECs have become more aggressive in pricing competition"); XO, Annual 10-K Report, at 4 (Mar. 2006) (the "telecommunications services market is highly competitive and continues to experience downward pricing pressure"); Cbeyond Communications, Annual 10-K Report, at 4 (Mar. 2006) ("we anticipate that aggressive price competition will continue").

[56] Casto Supp. Decl. ¶ 57. BellSouth's 2005 comments in this proceeding analyzed tariff rates for the 2001-2004 period rather than average revenue per unit inclusive of all discounts. Bellsouth has not increased any tariffed month-to-month or term DS1 or DS3 rates since 2004 (and recently reduced a number of those rate elements to implement an AT&T-BellSouth voluntary merger commitment). *See id.*

since pricing flexibility was granted, and that "the decrease appears to be consistent with the prospect of competition that the FCC predicted."[57]

Increased competition not only has reduced prices that customers pay but also has spurred all providers to improve service quality. For example, AT&T and various competitors also have developed numerous innovative services and features, including Ethernet substitutes for traditional TDM special access services like Ethernet, which allow business customers to connect local area networks, or LANs, across multiple locations in a metropolitan area. Ethernet services can provide customers with multiple uplink speeds and a variety of network configurations, depending on the customers' needs. Similarly, competition among providers has spurred tremendous amounts of network investment. To offer competitive dedicated access, alternative providers have consistently deployed fiber-based networks that can provide them with a competitive advantage over price cap LECs, which often provide special access over copper facilities. To compete against these providers' fiber networks, AT&T and other incumbent LECs have, in turn, made significant expenditures to add fiber to their special access facilities: AT&T spent more than **[BEGIN CONFIDENTIAL INFORMATION]**

[END CONFIDENTIAL INFORMATION] to continue the program.[58] Further, because of pricing flexibility, AT&T has continued to respond to competition and to work with its customers to develop custom tailored packages to meet their specialized needs. Since AT&T was first granted pricing flexibility, it has executed more than **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** unique customers that provide nearly **[BEGIN CONFIDENTIAL**

[57] GAO Report at 13.

[58] Casto Supp. Decl. ¶ 59.

INFORMATION] [END CONFIDENTIAL INFORMATION] in annual savings associated with price reductions on DS1 and DS3 services, and does not include the benefits of such other terms and conditions such as service level commitments and service portability, which are highly valued by AT&T's special access customers.[59]

II. IN VIEW OF THE RECORD ESTABLISHING ROBUST INTRAMODAL AND INTERMODAL COMPETITION AND FALLING PRICES FOR ALL SPECIAL ACCESS SERVICES, THE ONLY APPROPRIATE COURSE OF ACTION IS LESS, NOT MORE, REGULATION.

As shown above, experience has validated the Commission's increasing deregulation of the special access marketplace over the last two decades. The Commission has proceeded in a series of carefully measured steps: permitting volume discounts for private line services as early as 1984, then adopting incentive regulation to replace rate-of-return regulation, eliminating sharing and other transitional vestiges of rate-of-return regulation, adopting the process for further relaxation of price caps in particular MSAs and for particular services where it could be shown that facilities-based competition was irreversible, and finally accepting the CALLS plan. These steps have resulted in today's vibrantly competitive marketplace, marked by scores of facilities-based competitors serving every aspect of the market. As a result, special access customers have more and better choices today than they have ever had, as prices have consistently fallen, output has risen, investment has increased, performance has improved, providers have rapidly introduced a host of service innovations, and numerous intramodal and intermodal facilities-based competitors continue to enter. Indeed, each time the Commission has relaxed the price cap rules, the market has responded with more investment and more competition.

[59] *Id.* ¶ 60.

Accordingly, as AT&T and others demonstrated in 2005, the only sensible response to this track record is to take additional steps down the path of progressive deregulation. The Commission should immediately deregulate all OCn and packet-based services, which no commenter even two years ago denied are competitively supplied.[60] It is equally clear that the Commission should immediately extend Phase I pricing flexibility to *all* price cap-regulated special access services in all areas to allow price cap LECs to meet competition and offer customers multi-region contracts that allow them to purchase all levels of special access services in all areas on consistent, heavily discounted terms. The Commission should extend pricing flexibility to the highly competitive MSAs that fail to qualify solely because expansive facilities-based competition from intermodal and other providers is not counted under the existing collocation-based competitive triggers. And because this is a market in need of less, not more regulation, the Commission should emphatically reject requests that it turn the clock back by re-regulating special access services that were previously deregulated.

In this regard, the Commission must acknowledge that CLECs have thus far refused to provide any data about the true extent of their networks, facilities, service offerings and market successes. Because the Commission has not exercised its authority to compel the reporting of this information, the evidence of competitive facilities in the record will necessarily be incomplete, based on the partial information available to incumbent LECs such as AT&T. While the incomplete information available in the record is more than sufficient to compel further deregulation of special access services, the Commission could not defend an order re-regulating

[60] AT&T has a pending petition for forbearance seeking deregulation of such services. *See* Order, *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Broadband Services*, WC Docket No. 06-125 (July 7, 2007) (extending date on which petition will be deemed granted until October 11, 2007).

access services if it did not even require the submission of full and complete information on competitive deployment. As the GAO urged in its recent special access report:

> We have consistently noted the need for better data at FCC to track competition and deployment of telecommunications services to a variety of consumers. Without data that are reliable, relevant, and current, FCC is limited in its ability to adequately monitor the state of competition for dedicated access, and thus is limited in its ability to determine whether its predictive judgments were correct, and whether its deregulatory actions are achieving their goals.[61]

A. The Commission Should Expand Pricing Flexibility With The Additional, Targeted Reforms Necessary To Keep Pace With Marketplace Developments And Should Reject Requests To Eliminate Or Reduce Phase II Flexibility.

AT&T proposed in 2005 that the Commission immediately deregulate all OCn-level and packet-based services, because the record established, and no commenter seriously disputed, that competition was firmly entrenched for all such services.[62] As AT&T demonstrated, in such a fully competitive environment, "continued regulation, particularly rate regulation, is not only unnecessary but also counterproductive."[63] In the past two years, the market for OCn-level services has become even more competitive in all areas. Indeed, competitive providers routinely state publicly that they are the market leaders in providing Ethernet and other packet-based services.[64] The Commission, the Department of Justice and the courts have already recognized

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[61] *See* GAO Report at 43.

[62] SBC Opening Comments at 8, 10-12, 59-60.

[63] *Id.* at 12.

[64] *Id.* at 59 (citing Casto Initial Decl. ¶ 7); *see also* Press Release, Time Warner Telecom (June 6, 2006) (proclaiming that Time Warner Telecom is an "industry leader" with a "comprehensive portfolio of Ethernet Services"), available at http://www.twtelecom.com/Documents/Announcements/News/2006/Overture.pdf; Craig M. Clausen, MetroEthernet: Finally The Headliner, Telephony Online, June 18, 2007 ("Level 3 Communications [has] . . . greatly enhanced its capabilities via acquisition in 2006" and "[i]n even more dramatic fashion . . . Optimum Lightpath [Cablevision] quit TDM-based service cold turkey in 2005 in favor of metro Ethernet" and [i]ts revenues from Ethernet services have grown at triple-digit annualized growth rates in the past two years, and the company expects them to

that competitive providers can economically deploy facilities to provide OCn level services.[65] Accordingly, the Commission should adopt AT&T's proposal and immediately deregulate all OCn-level and packet-based special access services.

AT&T further proposed in 2005 that the Commission grant price cap LECs Phase I pricing flexibility in all areas for all special access services in order to allow LECs and their customers to negotiate the multi-region discounts that customers increasingly demand and desire.[66] Most commenters have already endorsed this proposal,[67] and certainly no commenter could seriously contend today that consumers could be harmed by downward pricing flexibility that allows LECs to offer lower contract prices to meet competition. As AT&T demonstrated, special access customers want to be able to negotiate multi-region contracts that allow them to purchase all levels of special access services in all areas on consistent, heavily discounted terms, but AT&T and other price cap LECs face constraints in negotiating such contracts because customers must pay price-cap rates in certain MSAs and for certain services.[68] These constraints

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double again in 2007"), available at http://telephonyonline.com/mag/telecom_metro_ethernet_finally.

[65] *See, e.g., Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd 16978, ¶ 315 (2003) (the "record evidence reflects competitive deployment of loops at the OCn level and competitive carriers confirm they are often able to economically deploy these facilities to large enterprise customers which use them," including customers in Tier II and Tier III markets"); *USTA* v. *FCC*, 359 F.3d 554, 575 (D.C. Cir. 2004) ("*USTA II*") (upholding FCC finding that OCn loops are competitive).

[66] SBC Opening Comments at 8-9, 60-62.

[67] *See, e.g.*, Ad Hoc at 50-52; Comptel at 31-32; Paetec at 13-15; XO at 13; ATX et al. at 35.

[68] The existing record also confirms that any concerns that downward flexibility might allow LECs to engage in predatory pricing (*i.e.*, pricing below average variable cost for the purpose of excluding competitors) are wholly unwarranted in today's environment with myriad actual and potential entrants. SBC Opening Comments at 61. Moreover, as the Commission recognized in 1999 (*Pricing Flexibility Order*, 14 FCC Rcd. 14221, ¶ 83), any accusation of such conduct could adequately be addressed by either the section 208 complaint process or antitrust law – and, notably, there have been no such valid complaints filed against AT&T in this time frame.

are manifestly unnecessary and affirmatively harmful, particularly given that price cap LECs' many intramodal and intermodal competitors are not subject to such regulations.

Finally, although AT&T has not previously sought changes to the Commission's current triggers for granting pricing flexibility, the Commission must recognize that the exclusive focus in the rules on fiber-based collocation in ILEC wire centers means that the triggers are vastly underinclusive. The Commission recognized this underinclusiveness in 1999, but it has become far more pronounced in today's marketplace, which is marked by widely-deployed carrier hotels, wireless facilities, and cable special access facilities – all of which provide competition to incumbent LECs' special access services widely throughout an MSA but which bypass many incumbent LEC wire centers entirely and thus do not count toward the pricing flexibility triggers.

The evidence of the underinclusiveness of the collocation-based pricing flexibility triggers is unmistakable in the marketplace: one merely has to look at some of the MSAs where AT&T has been unable to qualify for Phase II channel termination relief to confirm that, far from being too lenient, the existing test is far too stringent. For example, AT&T has not yet attained Phase II pricing flexibility for channel terminations in Chicago, Dallas, Houston, Detroit, San Francisco-Oakland, San Diego, and St. Louis – respectively, the 3rd, 5th, 8th, 9th, 12th, 17th and 18th largest MSAs and some of the most competitive areas in the country.

To address this anomaly, the Commission should modify its pricing flexibility rules to allow Phase I and Phase II flexibility even where the collocation triggers are not met, upon a showing that facilities-based competitors are providing service in enough wire centers where there is no collocation that the triggers would be met if those wire centers were counted. When

applicants can make the specific showing of actual facilities-based competition, the underlying purposes of the pricing flexibility regime are advanced if flexibility is allowed.[69]

Finally, the record of vigorous competition and continuing price declines established in this proceeding plainly rebuts any factual basis for eliminating or reducing the availability of Phase II pricing flexibility. Because competitive fiber blankets the dense commercial areas where special access demand is concentrated, those that seek to reduce the availability of Phase II pricing flexibility have long premised their advocacy almost entirely on claims that competitive alternatives do not currently exist for *all* customers at *all* locations, particularly for DSn-level channel terminations outside the commercial centers where traditional wireline CLEC networks are most prevalent. These arguments have been misguided from the outset, given the Commission's appropriate recognition "that the costs of delaying regulatory relief outweigh the potential costs of granting it before [customers] have a competitive alternative for each and every end user."[70] But now that the promise of intermodal competition by the myriad cable and

[69] The Commission also should reduce unnecessary regulatory burdens by adopting AT&T's proposal to streamline the outdated price-cap basket structure for special access. *See* SBC Opening Comments at 62-65. First, the Commission should eliminate the "Wideband Data & Analog" special access basket, which has long been an irrelevant service category (AT&T has not had any demand in that category since it was adopted in 1990). Second, the Commission should authorize the removal of any remaining OCn-level and packet-based demand and revenue from the price cap baskets because, as noted, such services are subject to robust competition and the Commission should deregulate all such services. Third, the remaining service categories should be streamlined as follows: (i) a separate service category should be created for "DS3 & below Channel Termination to End Users" and (ii) an "All Other" service category that would house all remaining voice-grade and below DDS, DS1, and DS3 special access services, thus eliminating the need for any separate baskets or categories. By grouping services consistently with the way they are competitively supplied in the marketplace, this more streamlined and rational approach is vastly superior to the existing outmoded regime.

[70] *Pricing Flexibility Order*, 14 FCC Rcd 14221, ¶ 144. *See also, e.g., Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, 20 FCC Rcd. 14553, ¶¶ 44, 77-80 (2005); Joint Statement of Chairman Kevin J. Martin and Commissioner Deborah Taylor Tate, *Verizon Telephone Companies' Petition For Forbearance From Title II*, WC Docket No. 04-440, at 2 (March 20, 2006) (discussing numerous decisions where "the Commission determined

wireless special access providers that are specifically targeting the DS1 and DS3 channel termination demand at locations outside downtown and other commercial centers has indisputably been realized, the entire premise of arguments for reducing the availability of Phase II pricing flexibility has been eliminated.

Nor could any commenter make a serious argument that the Commission's essential economic theory is flawed or that there is another available regulatory mechanism that would more effectively measure competition without creating massive administrative burdens. In these circumstances, the public interest could only be harmed by any attempt to eliminate or further restrict the availability of Phase II pricing flexibility. Instead, the Commission should continue its deregulatory course and adopt the targeted extensions of pricing flexibility that AT&T has outlined here.

B. The Commission Certainly Should Not Reverse Years of Deregulatory Progress By "Reinitializing" Price Caps Or Increasing the X-Factor.

For many of the same reasons, there remains no justification for extraordinarily radical proposals arbitrarily to reduce the rates of special access services that remain subject to price caps, either through one-time "reinintialization" of price caps or recurring "X" or "g" factor reductions. All of these proposals are premised on the notion that LECs are earning excessive *returns* in special access services, and that the Commission should reduce special access rates to produce a return perceived to be more reasonable. That claim, in turn, is based on a blatant misuse of ARMIS data, as explained in detail below and in AT&T's 2005 comments in this proceeding. But apart from the fact that there is no credible evidence that special access returns are unreasonably high, there also is no remotely tenable means by which to re-regulate special

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to relax regulations where competition was significant and where regulations acted as a disincentive" for innovation).

access services. Those who would force special access rates down to some arbitrary benchmark fail completely to explain on what basis such a benchmark lawfully could be based. That the Commission was never able to obtain judicial approval of even an enterprise-wide productivity factor only underscores the treacherous nature of the path to re-regulation: a defensible service-specific productivity factor would be even more difficult to devise. Nor do re-regulation proponents explain how, even assuming BOC special access returns were too high, the Commission lawfully could force those returns down while ignoring the effect on the BOCs' enterprise-wide returns, particularly given that the same ARMIS data they cite for their claims of "excessive" special access returns yields switched access returns that have long hovered near zero and have often been *negative*. In short, the case for re-regulation is built on smoke and mirrors, and it would be virtually impossible for the Commission to implement such proposals on anything but a purely arbitrary and legally indefensible basis.

Re-regulation also would be completely inconsistent with the core premises of price cap regulation. When it switched to price cap regulation nearly two decades ago, the Commission explicitly and quite intentionally severed the relationship between costs and rates that had characterized the rate of return regime. As the Commission explained at the time, it did so in order to replicate the efficiency incentives of a competitive market, to create profit-driven incentives for increased investment and innovation, and to relieve the Commission and the industry from the resource-wasting and investment-chilling uncertainty of never-ending rate proceedings.[71]

In their zeal to obtain lower rents at any cost, the proponents of price cap reductions ask the Commission simply to ignore this history. As the record established in 2005 starkly

[71] *See, e.g.*, Second Report and Order, *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, ¶¶ 1-4 (1990) ("*LEC Price Cap Order*").

illustrates, doing so would destroy the efficiency incentives of price cap regulation, punish price cap LECs for acting on the very incentives price cap regulation was designed to create, and embroil the industry in extraordinarily costly and time-consuming rate proceedings that past experience shows would create debilitating uncertainty that would chill investment by both ILECs and their competitors to the detriment of all consumers. Such re-regulation explicitly designed to force rates below market-driven levels would also expose the Commission to litigation and further deter the deployment of alternative facilities. And equally important, such action would undermine the Commission's credibility, and limit its ability to rely upon incentive-based regulation in the future because neither regulated firms nor investors would trust the Commission to follow through.

Mandated Rate Reductions Through "Reinitialization." As AT&T and others previously demonstrated, there is no basis for any attempt to reinitialize or re-impose price caps on special access services. In the absence of any showing that current rates are systematically unjust and unreasonable, such re-regulation would only punish LECs for responding to the incentives provided by the price cap regime to invest in advanced facilities and to become more efficient, and it would consign the Commission and the industry to endless litigation that has no hope of ultimately providing either special access purchasers or consumers any concrete benefits over the current regime.

To begin with, any attempt to mandate rate reductions through reinitialization of price caps would face extremely high legal hurdles, because such a rule change would represent a sharp break with past precedent that could be adequately justified only if the Commission has first made an affirmative finding that *current* special access rates are outside the zone of reasonableness. The Commission has repeatedly reiterated that "our access charge rules are

designed to ensure that access charges remain within the 'zone of reasonableness' defining rates that are 'just and reasonable.'"[72] If current rates are within that zone of reasonableness, then there could be no need for new regulations, unless the Commission were going to abandon that policy – an outcome that no party advocates (and that the Commission could never defend). Moreover, the Commission has repeatedly held that aggressively regulating special access rates to limit LEC *returns* imposes substantial costs on the industry (and, in turn, the economy), by dampening incentives for investment and efficiency, and that – even worse – *modifying* existing price caps to limit returns would do lasting damage to the cost-cutting incentives that are the purpose of the price cap regime.[73] Accordingly, when current rates are within the zone of reasonableness – as they clearly are in light of the powerful market forces generated by intense facilities-based competition in all areas and at all levels of demand – any attempt to re-regulate LEC returns would inflict severe economic inefficiencies on the market without any corresponding benefits. No reviewing court would permit these concededly severe costs of re-regulation merely to satisfy sophisticated special access customers' desire for even steeper rate reductions than market forces have produced.[74]

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[72] *Implementation of the Local Competition Provisions of the Telecomms. Act of 1996,* 12 FCC Rcd 15982, ¶ 273 (1997) ("*Access Reform Order*").

[73] *See, e.g., Access Reform Order*, 12 FCC Rcd 15982, ¶ 292 (reinitializing price caps "could have a negative effect on the productivity incentives of the LEC price cap plan"); *id.* ¶ (rate prescription would "mak[e] carriers less confident in the constancy of regulatory policies"); *Price Cap Performance Review for Local Exchange Carriers*, 12 FCC Rcd 16642, ¶ 151 (1997) ("*1997 X-Factor Order*") (noting that sharing – *i.e.*, reducing access rates because of high returns – was "inconsistent with the general competitive paradigm that was established in the 1996 Act" because it dampens incentives to become more efficient).

[74] *Motor Vehicle Mfrs. Ass'n* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (agency action is arbitrary and capricious if the agency has not "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choice made") (internal quotations omitted).

It would take a very substantial showing of market failure for the Commission even to consider reviving the process of cost-based regulation, but all of the evidence points in exactly the opposite direction. As explained in detail above, special access markets are robustly competitive today and have become significantly more competitive since 2005; intramodal and particularly intermodal competitors continue to proliferate and offer special access alternatives at all bandwidth levels; and special access rates have been steadily falling for years in both price cap and pricing flexibility areas – as the GAO study confirmed. Nothing has changed in the past two years that could overcome the public interest and legal hurdles to reneging on the promise of incentive regulation. To the contrary, the need to avoid investment-destroying uncertainty and regulatory flip-flopping is if anything even more critical in the current environment in which intermodal competitors are investing heavily in deploying special access alternatives.

Despite having years to come up with a case, no party to this proceeding has come remotely close to showing that today's special access rates are outside the statutory zone of reasonableness. Instead, proponents of new special access regulations have produced only meaningless ARMIS returns, erroneous allegations of price increases based on "rack rates," and manifestly incorrect assertions that there are no alternative suppliers.

With respect to ARMIS returns, AT&T, economists and other carriers have demonstrated, and the Commission has acknowledged, that ARMIS data do *not* accurately depict incumbents' actual returns for special access. The service-specific cost data reported in ARMIS are obtained by applying the Part 32 rules, which require regulated carriers to apportion their plant investment and other costs into myriad categories – many of which are hopelessly outdated – and then further to separate these categories of costs into interstate and intrastate amounts. The interstate portions of these separated costs must then be apportioned among interexchange

services and rate elements – such as special access, carrier common line, or traffic sensitive – under Part 69 of the Commission's rules, and reported as such in ARMIS. The special access returns generated by ARMIS thus are only as good as the myriad separations and allocation rules governing how an incumbent's costs are to be allocated to special access. And as shown in AT&T's initial comments and below, those rules provide a wholly inadequate means of allocating costs for purposes of determining a service-specific rate of return.

Indeed, the Commission has long recognized as much. It has noted repeatedly that ARMIS data were never intended to be used to determine rates on a service-specific basis, but rather are relevant only to evaluate returns of the enterprise as a whole.[75] And it has repeatedly acknowledged that its ARMIS accounting rules are "outdated regulatory mechanisms that are out of step with today's rapidly evolving telecommunications marketplace."[76] Hence, even if the separations and allocation rules might have been roughly accurate in the era of rate-of-return regulation, those separations and allocation rules have not kept pace with the dramatic changes in the telecommunications industry – such as the introduction of broadband networks and the convergence of wireless, broadband and telephone services – that have occurred in the past 20 years or so. Indeed, for the past 17 years, the Commission has had little or no incentive accurately to track the incumbents' costs through these complex separations and allocation rules, because price cap regulation made such costs largely irrelevant. And, in 2001, the Commission

[75] Order on Reconsideration, *Policy and Rules Concerning Rates for Dominant Carriers*, 6 FCC Rcd. 2637, ¶ 199 (1991) (category-specific returns reported in ARMIS "do not serve a ratemaking purpose").

[76] *Jurisdictional Separations and Referral to the Federal-State Joint Board*, 16 FCC Rcd. 11382, ¶ 1 (2001) ("*Separations Freeze Order*") ("rapid changes in telecommunications infrastructure" will cause "cost shifts in separations results because these and other new technologies . . . as well as a competitive local exchange marketplace" have not been appropriately incorporated into the "current Part 36 rules"); Notice of Proposed Rulemaking, *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, 12 FCC Rcd. 22120, n.86 (1997) ("*Separations NPRM*").

froze the separations and allocations rules altogether, precisely because those rules had become outdated and were not, in any event, being used for a ratemaking purpose.[77] Consequently, the "cost" figures found in ARMIS today were assigned using the facially unreasonable assumption that incumbents incur those costs in the precisely same manner as they did over six years ago.[78] Thus, the ARMIS rules have become even more disassociated from reality than they were in 2001, when the Commission already had recognized that those rules were out of step with market realities. For all these reasons, there is no reasonable basis to believe that the ARMIS "cost" figures accurately reflect the true market cost of providing any service in today's environment.

Similarly, the re-regulation proponents' claims that special access "rack rates" – *i.e.*, tariffed month-to-month rates with no term or volume discounts applied – have increased and that such increases demand re-regulation are misguided and wrong. As an initial matter, the premise of this argument is itself wrong – with only a handful of exceptions AT&T has not raised even rack rates for any special access rate elements in either price cap MSAs or Phase II MSAs in years. In any event, a showing that some rack rates had increased would be of no

[77] *Separations Freeze Order*, 16 FCC Rcd. 11382 ¶¶ 1-2. Even prior to the separations freeze, the Commission was already acknowledging in the late 1990's that a comprehensive review of the separations factors was necessary in light of the fundamental changes in telecommunications networks that had already taken place. *Separations NPRM*, 12 FCC Rcd 22120, ¶¶ 9-16.

[78] As AT&T and other have previously explained, this freeze has particularly distorted the cost figures for special access. Since 2000, special access volumes and revenues have grown substantially, while switched access lines and combined interstate common-line and traffic-sensitive revenues have significantly decreased. Increasing fractions of what the BOCs are investing and spending to provide service should thus be attributed to special access and a reduced fraction attributed to switched access. As a result, while special access revenues continue to increase, the allocation rules make incumbents' costs appear artificially low, producing grossly overstated purported rates of return. Thus, as the Commission has explained, "[h]igh or increasing rates of return calculated using regulatory cost assignments for special access services do not in themselves indicate the exercise of monopoly power." Order and Notice of Proposed Rulemaking, *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, 20 FCC Rcd. 1994, ¶ 129 (2005) ("*Special Access NPRM"*).

relevance here because very few special access customers pay the rack rate.[79] Rather, almost all special access customers purchase services under term and/or volume or contract tariffs that provide very steep discounts (that have increased substantially in response to competitive pressures) off of the rack rates.[80] As the Commission acknowledged just a few months ago, "it is clear that the simple tariff rate used by [re-regulation proponents] is not adequate" to show "how much each buyer pays" for special access services.[81] And, as described above, the prices that customers are actually paying for special access services – accounting for all relevant discounts – have been going down in pricing flexibility areas since 2001.[82]

Finally, claims that a lack of competitive alternatives establishes a need for new special access regulations are patently false. As demonstrated above, AT&T and other special access

[79] What is worse, some re-regulation proponents myopically focus only on certain tariff rates, such as prices for channel terminations, without considering the rates for other special access services that may have been subject to more significant price decreases. This results in grossly misleading pricing data, because special access customers generally purchase an end-to-end circuit which includes channel terminations, transport, and other services. Any discussion of special access pricing that focuses on one type of rate is akin to an assessment of car prices that examines only the price of the tires.

[80] These substantial discounts – which are becoming both more prevalent and more substantial as incumbents increase them to avoid losing customers to CLECs and to cable and wireless providers – mean that the base rates found in special access tariffs simply are not a meaningful measure of the average prices actually paid by special access customers. In addition, because of robust competition, AT&T and other incumbent LECs now often include in these plans and individualized contracts non-price terms that provide additional benefits to the customer, so that the customer is obtaining higher quality services (such as service quality and performance guarantees, service portability clauses, and technology-upgrade provisions) than previously received – meaning that simple comparisons of tariff prices overlook the fact that customers are receiving better service for the same and even lower rates.

[81] *AT&T Inc. and BellSouth Corp. Application for Transfer of Control*, 22 FCC Rcd. 5662, ¶ 53 n.142 (2007) ("*AT&T-BellSouth Merger Order*"); *SBC Commc'ns and AT&T Corp. Applications for Approval of Transfer of Control*, 20 FCC Rcd. 18290, ¶ 43 n.117 (2005) ("*SBC-AT&T Merger Order*").

[82] The few customers that do pay the rack rate do so because they place a high value on the flexibility to terminate service and switch providers quickly and without restrictions – still further confirmation that special access customers have competitive alternatives to price cap LEC services.

providers face vigorous competition from many facilities-based providers, including other fiber-based LECs, cable providers, and broadband wireless providers.

In short, none of the re-regulation proponents' arguments comes remotely close to establishing that incumbent LECs' special access rates are outside the statutory zone of reasonableness. Accordingly, if the Commission were serious about re-regulating special access, it would have no choice but to conduct a full-blown rate case. That would be an extraordinary waste of resources: the Commission has not made any serious attempt to regulate special access prices on the basis of cost in seventeen years, and thus the Commission would have to start completely from scratch. But, as detailed further in Part III below, accurately estimating the "costs" of highly dynamic telecommunications services provided over common multi-service networks in any reasonable time frame is not remotely feasible. And even after the lengthy proceedings that would be required to estimate costs, such cost models would almost necessarily be arbitrary, because many special access costs are joint and common costs associated with a wide range of services provided over common network facilities. Consequently, any attempt to estimate special access costs would be driven almost entirely determinations of how to allocate the cost of these commonly used facilities to special access – a determination that would be inherently arbitrary and extremely difficult to explain or defend. Nor could the Commission re-regulate special access returns in isolation; it would also have to take a fresh look at switched access rates, where ARMIS returns have become negative. In short, any notion that the Commission is in a position at this late date to make meaningful service-specific cost determinations that would result in price caps or rates that are more "accurate" than the rates that are generated in today's intensely competitive marketplace, or that would in any way further the goal of this proceeding to determine the circumstances under which special access services

should be freed from price cap regulation, borders on the absurd and is completely inconsistent with the Commission's mandate to adopt a de-regulatory national policy framework.[83]

After many years of intense and steadily increasing facilities-based competition, the Commission has no grounds today for starting a process for making a regulatory determination of special access costs as if this were the 1980's. Indeed, even beginning a regulatory proceeding that signaled that the Commission was seriously considering returning to a regime in which LEC special access prices would be tied to Commission-determined estimates of costs would severely discourage network investment and destroy the current regime's powerful efficiency incentives. The Commission's price cap, pricing flexibility, and CALLS policies have been enormously successful in allowing substantial special access competition to flourish, and there could be no more inappropriate response to this success than to re-impose long discredited cost-plus rate regulation on these competitive services.

X-Factor. Nor has any commenter in this proceeding provided any grounds for modifying the X-Factor. The Commission's current rules already contain a robust X-Factor for special access services. The current rules require annual cap adjustments to reflect the combined effect of two factors: inflation and an offset for expected productivity gains that, under the *CALLS Order*, is set equal to rate of inflation. In other words, the rules freeze the price caps, and prevent price cap LECs from raising rates to counter the very real effects of inflation, on the assumption that productivity gains in the provision of special access services will exceed productivity gains in the economy as a whole in an amount equal to the inflation adjustments to which LECs would otherwise be entitled. This assures that rates will decline each year in real terms, even if nominal rates remained constant – as they have not.

[83] Preamble, Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (Act is intended to "promote competition *and reduce regulation*").

There is absolutely no evidence that the existing X-Factor is so grossly off-target that the Commission should go back to its unsuccessful practice in the 1990's of attempting to develop models for estimating LEC productivity gains. That process resulted in protracted rulemaking proceedings, judicial reversals, and substantial uncertainty that disrupted the business expectations and investment decisions of both LECs and new entrants and should not be revived. That history is worth reviewing. After the initial phase of price cap regulation, the Commission concluded in 1995 that the most accurate way of measuring LEC productivity going forward would be to undertake a "total factor productivity" analysis.[84] The Commission conducted a two-year rulemaking proceeding with an extensive record, which required the Commission to resolve a number of methodological disputes, including the critical issues of which historical data points to include in its analysis and what adjustments to make to account for how future productivity might differ from the historical pattern (which, even under the Commission's new methodology, bounced around quite a bit from year to year).[85] The D.C. Circuit vacated the Commission's order, and held that the Commission had "failed to state any coherent theory" for how it had used historical productivity calculations to estimate future LEC productivity gains.[86] On remand, the Commission staff produced three new alternative productivity studies, but the commenters disagreed both on which study was most appropriate and on many fundamental aspects of the studies' methodologies, including such central issues as how to determine LEC

[84] Fourth Further Notice of Proposed Rulemaking, *Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd 13659, ¶ 25 (1995); *see also* First Report and Order, *Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd 8961, ¶ 155 (1995).

[85] *1997 X-Factor Order*, 12 FCC Rcd 16642 (1997).

[86] *USTA* v. *FCC*, 188 F.3d 521, 525-26 (D.C. Cir. 1999).

cost of capital, how to measure output, and whether to use total company or interstate-only data – with the resulting X-Factor varying enormously depending on how these issues were resolved.[87]

It was the very hopelessness of the Commission's task on remand – and the likelihood that the uncertainty of the X-Factor litigation would continue for the foreseeable future, with serious consequences for business planning and investment – that was a major reason that the entire industry, including both access purchasers and sellers, came to the table to negotiate the CALLS Plan in 1999. The CALLS Plan eliminated the need for the remand proceeding by a mutual agreement to set the X-Factor equal to inflation (thus freezing the caps) and severing the tie between the X-Factor and ongoing Commission measurements of productivity.[88] A grateful Commission adopted this plan in 2000, noting that it went a long way toward "undoing the Gordian knot of determining the appropriate level of interstate access charges and converting implicit subsidies in interstate access charges into . . . universal service support."[89] Even then, although the Fifth Circuit upheld most of the complex *CALLS Order*, that court once again zeroed in on the X-Factor and held that the Commission had not adequately explained how it had

[87] Further Notice of Proposed Rulemaking, *Price Cap Performance Review for Local Exchange Carriers; Access Charge Reform*, 14 FCC Rcd. 19717, ¶¶ 20-39 (1999).

[88] *See* Sixth Report and Order, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long-Distance Users; Federal-State Joint Board on Universal Service*, 15 FCC Rcd 12962, ¶ 40 (2000) ("*CALLS Order*") (CALLS Plan "treats the X-Factor not as a productivity estimate but as a method to reduce rates to certain levels"); *see also id.* ¶ 41 n.51 (noting that if the rate of inflation rises above current levels, LEC rates would be forced down in real terms even more quickly).

[89] *CALLS Order* ¶¶ 26-28; *see id.* ¶¶ 160-84.

determined the appropriate size of the annual adjustment.[90] The issue finally became moot only in 2003 when no party appealed the Commission's order on remand.[91]

Accordingly, after years of litigation and uncertainty, the Commission has finally arrived at a sustainable, regulatory equilibrium: the X-Factor is set equal to inflation, which ensures that rates continuously decline in real terms, with adequate space for the vast majority of special access rates to be set through market negotiations that result in even more rapid price reductions. Against this backdrop, any attempt by the Commission to supplant these market outcomes by a return to inherently arbitrary estimates of "actual" LEC productivity gains would be lunacy. As with cost models, it has been over ten years since the Commission produced any estimate of LEC productivity that survived judicial review, and eight years since the Commission even tried, and thus the Commission would have to start completely from scratch. No party to this proceeding, however, has submitted a productivity study, but even if they had, the Commission would still have to pick up where it left off in 1999, with a whole host of fundamental, unresolved methodological issues. The result would inevitably be, once again, intractable litigation and crippling uncertainty, and the negative effects on investment incentives would far outweigh whatever dubious marginal gains in the accuracy of the X-Factor might be achieved.

Indeed, those methodological issues would be even more difficult in these circumstances, because the Commission has never even attempted to develop a productivity offset for a single service (as opposed to interstate services generally). As a theoretical matter, total factor productivity growth can be calculated only on a firm-wide or industry-wide basis, not on a

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[90] *Texas Office of Public Utility Counsel* v. *FCC*, 265 F.3d 313, 328-29 (5th Cir. 2001) ("the FCC has failed to show a rational basis as to how it derived the 6.5 percent figure").

[91] Order on Remand, *Access Charge Reform; Price Cap Performance Review for LECs; Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service*, 18 FCC Rcd. 14978 (2003) (readopting 6.5 percent X-Factor for early years of CALLS Plan).

service-specific basis. Special access is provided using many of the same inputs – the same network facilities and overhead – that are used to provide LECs' other services, and there is no economically coherent method for isolating which inputs, or portions of inputs, are used to provide special access services.[92] Accordingly, the Commission has no hope of designing a non-arbitrary means of measuring service-specific productivity gains for special access. While the Commission may have a better chance of estimating industry-wide productivity gains – and even there its previous attempts have had trouble surviving judicial review – it would be equally arbitrary to single out special access and apply a broad-based productivity measure, encompassing many different services, to that single service. In all events, long run estimates of telecommunications productivity have generally been in the range of 2-3 percent annually, which simply confirms that the Commission's current rules already contain a reasonable X-Factor.[93]

Nor could the Commission rationally adopt Ad Hoc's short-cut method of estimating a X-Factor, the "imputed" X. In its 2005 reply comments Ad Hoc attempted to "reverse engineer" an X-Factor by calculating what X-Factor would have limited special access returns to 11.25 percent over a given historical period. This study, however, suffers from many of the flaws discussed above and in Section III below, including the fact that it is based on ARMIS data which were never intended for this purpose and which have become all the more unreliable, and that it incorrectly assumes that the appropriate rate of return is 11.25 percent. As AT&T has previously shown, the increases in the ARMIS-determined "rate of return" for special access is almost entirely the artificial result of the separations freeze and other ARMIS anomalies, not

[92] *See, e.g.*, Verizon Comments at 42-43 & Declaration of William Taylor ¶ 66, *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25 (filed June 13, 2005) ("Verizon Comments" and "Declaration of William Taylor").

[93] *See* Verizon Comments at 43 & Declaration of William Taylor ¶ 68.

productivity gains.[94] And the Commission, in its *Notice* (at ¶ 130), has already rejected the Ad Hoc approach, noting that it would "go well beyond restoring the rate levels that would have been in place had the Commission never adopted the pricing flexibility rules that have been challenged." In short, no party has provided any sound basis for revisiting the X-Factor.[95]

III. ANSWERS TO THE REMAINING QUESTIONS POSED IN THE NOTICE ONLY CONFIRM THE ROBUST COMPETITION FOR SPECIAL ACCESS AND THE NEED FOR FURTHER DEREGULATION.

Although the *Notice* fails to seek the information to fill the one serious gap in the record – *i.e.*, the detailed information that competitive special access providers have refused to provide about the reach, capabilities and uses of their networks and services – it does seek information and comment on a number of other specific topics of much more limited relevance. In particular, the *Notice* seeks information regarding how the Commission should i) assess the impact of industry consolidation on the availability of competitive alternatives; ii) analyze the impact of special access pricing on particular industry segments; iii) define markets and analyze demand and supply responsiveness; iv) interpret the GAO's report on special access; and v) evaluate methods for estimating the costs of providing special access services. All of these issues have been made irrelevant, however, by the near ubiquitous intramodal competition in the commercial centers where special access demand is concentrated, the spread of intermodal technologies outside these commercial centers that are specifically targeted at DSn-level demand, and price

[94] *See* SBC Opening Comments at 31.

[95] As AT&T previously explained, there is also no reason to force rate reductions by importing a "g" factor into the special access context. Like many of the claims regarding the X-Factor, the argument for the "g" factor is that ARMIS data suggest that LECs are experiencing increasing economies of scale. As explained above, however, ARMIS data are wholly unreliable for purposes of calculating a "g" or any other factor, and if anything LEC economies of scale are decreasing as they lose market share. Imposing a new "g" factor would accomplish nothing other than to double-count productivity gains, and it should be rejected. *See* SBC Opening Comments at 47-48; SBC Reply Comments at 46-50.

cap LECs' long track record of responding to these competitive pressures. But answers to these questions only reinforce the conclusion that the special access marketplace is in need of less, not more, regulation.

Industry Consolidation. The *Notice* (at 2) asks commenters to address "the effect of the post *Special Access NPRM* mergers and other industry consolidation on the availability of competitive special access facilities and providers" as well as "the effect these mergers may have had on scale economies or the profitability of special access services." Recent industry consolidation has had only positive impacts on the availability of competitive special access facilities and providers.

As an initial matter, both the Commission and the Department of Justice have already recognized that the recent AT&T and Verizon mergers could have no adverse competitive impact on the provision of special access services in any market given the commitments of AT&T and Verizon to divest fiber connections to *100 percent* of the commercial buildings formerly served only by the merging parties that were deemed unlikely candidates for additional competitive special access connections.[96]

Moreover, the divestitures associated with the AT&T and Verizon mergers expanded the portfolios of several large facilities-based suppliers of special access services that compete aggressively with AT&T and Verizon in markets throughout the country (and that, unlike legacy AT&T Corp., use their fiber connections primarily for the provision of *wholesale* special access

[96] *See SBC-AT&T Merger Order*, 20 FCC Rcd. 18290, ¶ 24 ("We conclude, however, that the consent decree" by which "the Applicants agreed to certain divestures . . . should remedy any likely anticompetitive effects"); *Verizon Comm'ns and MCI Inc., Applications for Transfer of Control*, 20 FCC Rcd. 18433, ¶ 24 (2005) ("*Verizon-MCI Merger Order*"); *see also AT&T-BellSouth Merger Order*, 22 FCC Rcd. 5662, ¶ 27 (concluding that AT&T's voluntary commitment to divest IRUs to specified buildings "adequately remedies the potential harms").

services).[97] Recent CLEC consolidation has further strengthened the competitiveness of alternative providers, increasing key competitors' geographic reach and the scope of their product offerings, improving their financial resources, and spurring additional investment and innovation.[98] And, as detailed above, consolidation in the CLEC segment has been met with explosive intermodal entry and expansion, particularly in the provision of DSn-level services and outside the dense commercial areas with the greatest concentration of CLEC facilities, providing special access customers with more choices than ever before.[99]

Wireless Special Access Customers. The *Notice* seeks comment on how special access pricing has affected the price and availability of wireless services and investment in and deployment of wireless networks. The Commission need look no further than the *Eleventh CMRS Report* for the answer to this question.[100] There, the Commission found that the wireless market was highly competitive, marked by "intense" "[p]rice rivalry" and a myriad of other "competitive pressure[s]," which "continue[] to drive carriers to introduce innovative pricing

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[97] *See* Press Release, Level 3, Level 3 Completes Purchase of ATT Divestiture Assets (Apr. 4, 2007), available at http://www.level3.com/newsroom/pressreleases/2007/20070404.html; Press Release, AboveNet, Inc., AboveNet Acquires Metro Fiber from AT&T and Verizon (Apr. 4, 2007), available at http://www.abovenet.com/newsandevents/pressreleases/pr070404.html.

[98] *See* Casto Supp. Decl. ¶¶ 14-15.

[99] Any special access scale economies associated with the recent AT&T and Verizon mergers have no relevance to the reasonableness of special access prices or the appropriateness of deregulatory special access policies. Plainly any non-trivial scale economies associated with the combination of legacy AT&T with SBC and BellSouth and the combination of MCI with Verizon would be concentrated on interoffice transport, which indisputably remains intensely competitive with multiple facilities-based providers of various sizes successfully competing for both OCn and DSn business. There are no significant economies of scale associated with channel terminations, which require a separate connection to each building and end user, and there was, in any event, relatively little building overlap between legacy AT&T and legacy SBC and BellSouth (or between MCI and Verizon).

[100] Eleventh Report, *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, 21 FCC Rcd. 10947 (2006) ("*Eleventh CMRS Report*").

plans and service offerings, and to match the pricing and service innovations introduced by rival carriers."[101] The short answer to the Commission's question is that the nation's wireless carriers (and consumers) have been among the greatest beneficiaries of the Commission's deregulatory pricing flexibility regime and the rate reductions, investment, entry and competition it has fostered.[102]

In particular, the evidence of robust competition, falling prices, and network investment in the wireless market directly contradicts the claims that the special access services used to provide wireless services are priced anticompetitively: As to pricing, in 2005 alone, average revenue for wireless services dropped by 22 percent to just 7 cents per minute – far less than the 22 cents per minute in 1999, when the Commission adopted its pricing flexibility rules.[103] Significantly, the Commission found that "mobile voice calls are still far less expensive on a per minute basis in the United States than in Western Europe and Japan" – and prices are lower even though "the United States continues to lead the world in average minutes of use per subscriber."[104] Further, the Commission determined that wireless carriers are investing billions in "the deployment of next-generation networks," which "continues to be an important dimension of non-price rivalry in the U.S. mobile telecommunications market" – and one that "has given the United States an edge over Europe in wireless data networks for the first time in

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[101] *Id.* ¶¶ 1-5, 150.

[102] Robust competition "between wireless carriers continues to yield significant benefits to consumers," including substantially lower prices." *Id.* ¶ 5; *see id.*, Statement of Commissioner Robert M. McDowell at 1 (stating that there are "so many positive developments in wireless sector," including decreasing prices, which is "great news for consumers," who have clearly "benefited from this competition").

[103] *Eleventh CMRS Report* ¶ 154 & Table 10.

[104] *Id.* ¶¶ 5, 189.

years."[105] Over these high-capacity networks, carriers are offering "innovative broadband services using advanced technologies [that] allow customers to use new multimedia phones to watch TV, download songs, receive information and access content . . . at broadband speeds."[106]

These advances and pro-consumer benefits are hardly the markers of an industry whose growth is hampered by the alleged problems with special access services, and the courts and the Commission have made clear that industries that enjoy such success are in no position to claim the need for regulatory protection from special access prices.[107] Indeed, the Commission's *Eleventh CMRS Report* discussed in minute detail the potential entry barriers into the wireless market, and there was no suggestion at all that special access prices affected entry.[108] The reality here is that the experience of wireless carriers starkly confirms the success of the Commission's deregulatory special access policies and the need for further deregulation.[109]

Moreover, as described above, the explosive growth of wireless services and the dramatic transformation of wireless networks from voice networks to networks that carry voice, data, music, and video has propelled unprecedented intermodal competition in the provision of special access services. To provide these advanced data services, wireless providers are increasingly substituting DS3, Ethernet or other higher capacity circuits for the DS1 circuits previously

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[105] *Id.* ¶ 3.

[106] *Id.*, Statement of Commissioner Robert M. McDowell, at 1.

[107] This is precisely what the Commission and the Court of Appeals concluded the last time independent wireless carriers claimed that immediate regulatory intervention was needed to protect them from special access prices: "[w]here competitors have access to necessary inputs at rates that allow competition not only to survive but to flourish, it is hard to see any need for the Commission to impose the costs" of increased regulation. *USTA II*, 359 F.3d at 576.

[108] *See Eleventh CMRS Report* ¶¶ 59-84.

[109] *Id.*, Statement of Chairman Kevin J. Martin, at 1 ("These results demonstrate how a competitive marketplace – rather than economic regulation – provides the greatest benefit to the American consumer").

utilized for wireless backhaul.[110] Indeed, Sprint confirmed these trends in a letter it recently filed with the FTC, informing that agency that "[a]s [wireless] carriers' bandwidth requirements grow to accommodate the increasing broadband speeds demanded by customers, more special access circuits (*i.e.*, more capacity) will be required to transmit the traffic" and backhaul it to the Sprint network.[111] As detailed above, there can be no doubt that wireless companies have a multitude of choices among special access providers, particularly in the last few years, as cable and wireless special access providers have rapidly expanded their competitive offerings. Broadband wireless providers can deploy service virtually anywhere in a matter of days or weeks. Further, cable companies, in addition to having fiber networks in the downtown areas of cities where most LEC fiber is deployed, also have hybrid fiber-coaxial cable and fiber networks in the urban, suburban, and more rural areas where a large portion of cell sites are located. Wireless providers, including AT&T Mobility, Verizon Wireless, T-Mobile, and Sprint, are all moving special access circuits from incumbent LECs to these intermodal providers. This competition will be a far more effective arbiter of special access rates paid by wireless carriers than any regulatory regime the Commission could devise.

Subdivision of Optical Fiber Services. The *Notice* (at 3) seeks comment on whether the Commission "should further subdivide optical fiber services into low capacity OCn services (such as OC-3) and higher capacity OCn services." There is no conceivable reason to do so. There is no serious dispute that *all* OCn services can be competitively supplied. Moreover, the already intensely competitive OCn marketplace is only becoming more so, particularly with the

[110] Olga Kharif, Sprint's Secret to Cost Cutting: Wimax, BusinessWeek, Dec. 27, 2005, available at http://www.buisnessweek.com/technology/content/dec2006/tc20061227_904530.htm ("wireless backhaul is exploding as cellular service providers start running more bandwidth-thirsty data, such as video and music, over networks").

[111] Letter of Robert S. Foosaner, Sprint/Nextel, to FTC, Office of the Secretary, Comment, Project No. V070000, at 2 (Feb. 28, 2007).

increasing development of wireless technologies and services that can provide OCn level service. As discussed above, the appropriate regulatory response is to completely deregulate all optical services.[112]

The Commission particularly seeks information as to how much capacity competitors believe is necessary to justify building new facilities to serve customers.[113] In their prior comments, competitive special access providers have pointedly refused to provide information about the levels of demand they serve over the facilities they have built to many thousands of commercial buildings throughout the nation. It is nonetheless clear from the record that competitors can (and do) economically serve both DS3 and even DS1 demand over their fiber facilities that are connected to or very near the commercial buildings that account for the majority of this special access demand.[114] The new evidence that cable and wireless providers have rapidly expanded their special access services and are specifically targeting locations with only DS1 and DS3 demand provides further confirmation that alternative providers can serve virtually any location. Moreover, even if individual customers have only DS1 demand, competitors can and do deploy facilities in hopes of attracting multiple customers in the same building.

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[112] The *Notice* (at 3) also observes that the Commission previously asked for comment on whether DS1 level services are in the same product market as higher capacity services. As AT&T previously explained, there is no need to answer this exceedingly complex question because, regardless of where precise product definition lines might be drawn, there is ample evidence in this proceeding that confirms that there is no justification for increased regulation of *any* special access services. This particularly true given the growing shift in demand from DS1 to DS3 and higher capacity services, which makes any static market definition meaningless.

[113] *Id.*

[114] *See* Casto Initial Decl. ¶¶ 14-15 (explaining the costs of deploying fiber where conduit does and does not already exist).

GAO Report. The *Notice* (at 3) invites comment on the analysis and findings in the GAO Report. Although the GAO Report relied on flawed and incomplete data and is flawed in other respects as well, AT&T fully endorses the two principal conclusions of the GAO Report. First, the GAO Report found that in both Phase I and Phase II pricing flexibility MSAs, prices have significantly decreased since pricing flexibility was granted. *See* GAO Report at 13. The GAO's core finding on pricing of special access is thus entirely consistent with the data that AT&T has provided to the Commission in 2005 and in these comments, which show real price decreases for all types of special access circuits. As the GAO Report acknowledges, these price decreases are "consistent with the prospect of competition that FCC predicted" in the *Pricing Flexibility Order* that, once competitors have made sufficient sunk investment in alternative facilities, competition from these suppliers will prevent any anticompetitive pricing.[115]

Second, AT&T agrees with the other primary finding of the GAO Report, which was that the Commission has "limited data on competitors' provision of dedicated access services" and in particular has "no specific or current data on competitors' prices for dedicated access services or on the extent to which competitors have extended their networks."[116] GAO recognized that "[c]ompetitors are not required to file any financial or operational data" – a defect the Commission has previously acknowledged.[117] These competitors could, of course, voluntarily turn over information on their alternative facilities, and their refusal to do so indicates that their

[115] *Id.*

[116] GAO Report at 40.

[117] *Id.*; *see Pricing Flexibility Order*, 14 FCC Rcd. 14221, ¶ 96 (the Commission's de-regulatory efforts were being "hampered by the lack of verifiable data concerning competitors' revenues and facilities. Unlike incumbent LECs, competitors are not subject to Commission reporting requirements, and they are often unwilling to provide this information voluntarily").

facilities are likely far more extensive than is reported in other sources.[118] Such data would also very likely confirm that, as described above, the Commission's collocation triggers are underinclusive and that pricing flexibility should be expanded and not restricted.

Although AT&T endorses these core findings in the GAO Report, AT&T takes serious issue with much of the data relied on in the GAO report, as well as a number of the ways in which GAO interpreted the data it obtained. First, the GAO Report's suggestion that alternatives for dedicated access are not "widely available" (at 1) is based on fundamentally flawed information. For example, GAO's primary measure of alternative facilities consisted of a gross percentage of buildings lit, but this is not a meaningful metric for assessing whether an MSA is sufficiently competitive to warrant price cap relief. GAO's analysis also relies on incorrect assumptions regarding the nature and extent of demand for special access services, leading it to both overestimate the number of relevant buildings and underestimate the extent of competitive alternatives, and thus to conclude incorrectly that special access competition is limited. In particular, GAO focused on buildings with 18 lines (which it assumed were an appropriate proxy for buildings with a single DS1-worth of demand) as the baseline standard for calculating the universe of commercial buildings susceptible to alternative fiber deployment – notwithstanding that many such buildings likely have no demand for special access services.[119] GAO compounded this error by incorrectly assuming that incumbents have deployed fiber to all such buildings. In fact, the vast majority of buildings with demand for a single DS1 (or a handful of

[118] When a party has relevant evidence within its control that it fails to produce, that failure gives rise to an inference that the evidence is unfavorable to the party. *See Int'l Union, UAW* v. *NLRB*, 459 F.2d 1329, 1336 (D.C. Cir. 1972); *Vodusek* v. *Bayliner Marine Corp.*, 71 F.3d 148, 156 (4th Cir. 1995).

[119] For example, such buildings may house 18 different businesses, each with its own voice line, or several businesses with a few lines each. In either case, there may be no demand for DS1 or higher capacity services.

DS1s) are served over copper facilities (which, in the case of CLECs, may be provisioned over facilities leased as UNEs). By overstating the number of buildings in the denominator, GAO significantly understates the percentage of buildings with special access demand to which CLECs have deployed fiber.

More importantly, simply quantifying the number of buildings to which CLECs have deployed fiber says nothing about the share of the special access market that can be reached by competitive fiber. As AT&T has explained in numerous proceedings, including its prior comments in this proceeding, demand for special access services is highly concentrated. Consequently, even if CLECs had deployed fiber only to 6 percent of the buildings with potential demand for DS1 services, it is virtually certain that those buildings account for a significantly greater share of the overall demand for special access services. And, as noted above, GAO ignored the fact that CLECs have widely deployed fiber networks virtually everywhere there is appreciable demand for special access services, and can quickly and easily extend fiber to reach new locations. Thus, the fact that a CLEC may not have built out to a particular building ignores that it readily could do so.

The critical issue is, as the Department of Justice and the Commission have previously concluded, what level of special access demand is *contestable*, because demand for special access services is typically concentrated in a few wire centers and the existence of alternative facilities near a building is more than sufficient to ensure market-based prices even if the building is not currently served by alternative facilities.[120] The reality is that in pricing flexibility

[120] *See, e.g.*, Casto Supp. Decl ¶ 12 (noting concentrated demand); *AT&T-BellSouth Merger Order*, 22 FCC Rcd. 5662, ¶¶ 41-42, 46 & nn.111-14 (describing and adopting "screens" employed by DOJ to determine whether a building could be served by alternative facilities). In all events, even if alternative facilities did pass a relatively small proportion of the incumbents' customer base, that would be sufficient to constrain the risk of anticompetitive pricing. This is

MSAs the majority of the customer demand is subject to competition under these measures – a fact that is demonstrated by Mr. Casto's analysis and fiber maps, which show the commercial centers where demand is concentrated and the fiber facilities that multiple facilities-based providers have deployed to blanket these areas.[121] The GAO Report, by contrast, fails even to examine whether buildings could be subject to competition from nearby alternative facilities.[122]

Further, even if a gross percentage of buildings lit by competitors were an acceptable metric, the data relied on by GAO to compile this metric is flawed and underinclusive – as GAO acknowledged (at 21-22). Indeed, it is simply incongruous for GAO to conclude that the FCC needs to collect far more data regarding alternative providers' facilities, and yet also to suggest that these providers' facilities may not be widespread. GAO ignores the far more likely scenario, which is that competitors have not been forthcoming with data about the extent of their networks precisely because it shows that their facilities are extensive and that competition is flourishing. Notably, the basis for GAO's belief that competitors' special access services are not widely available is data from GeoResults and Telcordia's CLONES database (the source for GeoResults data). This data is notoriously incomplete and seriously understates the number of buildings served by alternative facilities – even Telcordia acknowledges that it does not know the extent of underreporting by competitive providers.[123] AT&T has previously pointed out that data in

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because incumbent LECs' pricing structure is typically not building-specific, there is a high proportion of sunk costs, and bypass would mean the incumbents would obtain no revenue at all from these facilities.

[121] Casto Supp. Decl. ¶¶ 10-12.

[122] This flaw is particularly troubling in light of the acknowledgment in the GAO Report that competitive entry as a general matter is "economically viable" except at very low levels of demand (*i.e.*, 3 to 4 DS1s) – and at that level UNEs remain almost universally available. GAO Report at 13.

[123] GAO Report at 21 ("According to Telcordia, data on competitive firms may be less comprehensive than data on incumbent firms, but a precise estimate of underreporting is not

CLONES may include fewer than half of the buildings lit by alternative providers.[124] Further, as discussed above, even though AT&T does not have access to complete data on alternative facilities, AT&T's internal data shows that there are far more buildings lit by competitors than indicated in these sources.[125] And although the GAO report claims that its analysis does not exclude the presence of cable and wireless access providers (at 47), the Report's assertion that wireless special access is currently being used only in "limited circumstances" (at 19) is flatly inconsistent with the marketplace evidence, described above and in Mr. Casto's supplemental declaration, showing that use of wireless special access services has exploded since 2005. And the Report views the significant penetration by competitors in Norfolk – which it attributes to cable special access competitors – as anomalous, when in fact cable companies have made special access services a focus of their business, which likewise has expanded exponentially since 2005.[126]

Second, despite its findings that real prices for special access have steadily decreased, the GAO's Report places an undue focus on its claim that "list prices and revenues" in Phase I areas

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available from Telcordia"). For these reasons, the GAO Report's speculative suggestion (at 52) that this data may also be overinclusive and that these "two errors offset one another to some degree" is simply unfounded.

[124] *See, e.g.*, Letter of Christopher M. Heimann, SBC Communications Inc., and Larry Lafaro, AT&T Corp., to Marlene H. Dortch, WC Docket No. 05-65, at 10 (July 15, 2005). Moreover, AT&T's physical inspections of hundreds of commercial buildings and their environs in connection with the SBC-AT&T and AT&T-BellSouth merger proceedings confirmed the existence of very substantial amounts of CLEC fiber and many building connections that are not reported in any publicly available source. Casto Supp. Decl. ¶ 20.

[125] *See supra* Part I; Letter of Christopher M. Heimann, AT&T, to Steve Martin, GAO, at 3 (Oct. 27, 2006) (an internal analysis of a sample of 800 CLEC-lit buildings in the former SBC region shows that CLECs registered buildings less than 70 percent of the time).

[126] Additionally, although GAO's Report acknowledges that UNEs are "functionally equivalents" to special access and are "less expensive" to competitors (at 8), it fails to account for the fact that competitive local carriers can and do use UNEs to provide special access. DS1 and DS3 loops are available, for example, in about 95 percent and 98 percent, respectively, of the wire centers in the Chicago MSA.

are lower than in Phase II areas.[127] Even assuming that prices and revenues in the Phase I areas studied by GAO were lower than in the Phase II areas, that result is not, as GAO contends (at 48), "incongruous" or in any way inconsistent with the Commission's predictive judgment that there is a greater level of competition in Phase II MSAs. It is simply not meaningful to draw any conclusions about the sufficiency of rate reductions in Phase II areas by comparing them to mandated rate reductions in Phase I areas – unless one assumes that regulation is superior to competition in determining rates. In fact, there are a host of reasons why rates in Phase I MSAs – which were set based on years of imprecise methods dictated by regulatory fiat – are not an appropriate benchmark for the rates set in a competitive market. As the FCC recognized in the *Pricing Flexibility Order* and as the GAO acknowledges, some price increases are to be expected because "regulation could have caused prices to be below costs in some areas because price-cap incumbents are required to offer the same 'average' price throughout a geographic area, although costs may not be uniform throughout that area."[128] In this regard, the price cap rates have been driven down not by any approved productivity factor but rather by an agreed-to "transitional mechanism" in the CALLS plan that could easily cause many price cap rates to be below competitive, market-based rates. This is particularly true because, when determining the appropriate level of the transitional mechanism in the CALLS plan, the proponents recognized that the reductions from that mechanism would not apply in MSAs where carriers received Phase II pricing flexibility – a fact that affected the size of the agreed-to transitional mechanism and that further undermines the use of price-cap rates as an appropriate benchmark for assessing the adequacy of price declines in Phase II areas. In short, the very limited Phase I and Phase II rate

[127] GAO Report at 1.

[128] GAO Report at 17; *Pricing Flexibility Order* ¶ 155.

comparisons in the GAO Report provide no meaningful insights into the level of competition in special access markets.

Cost Estimation. The *Notice* (at 2) also seeks comment on "methods that may be used to estimate the costs of special access facilities, including whether models may appropriately be used to estimate such costs." There is no possible basis to attempt the intensely regulatory task of estimating the costs of special access facilities. The record evidence here plainly reflects the success of the Commission's deregulatory policies and decades of experience confirm that any attempt to estimate the costs of special access facilities would embroil the industry and the Commission in intractable proceedings and litigation, creating uncertainty, chilling investment, almost certainly reaching the wrong answer – in short replicating all of the shortcomings of the prior regime that incentive regulation and pricing flexibility were designed to correct.

In all events, the Commission has not made any serious attempt to regulate special access prices on the basis of cost in seventeen years, and thus the Commission would have no choice but to start completely from scratch.[129] But accurately estimating the "costs" of highly dynamic telecommunications services provided over common multi-service networks is not remotely feasible – as vividly illustrated by the Commission's decade-long TELRIC cost modeling debacle. The Commission's TELRIC rules required unbundled network elements to be priced according to cost models of hypothetically efficient networks, and the development and

[129] The more general cost models mentioned in the *Notice* (at 2 n.10) would not be of any help in modeling special access costs. Unlike models for POTS or residential broadband, which presume that a network will be used to provide a similar service to nearly every location, special access is a designed service which is not provided to every location and whose characteristics can vary greatly depending on the customer's needs. As a consequence, there can be no presumption regarding a standard service architecture that can then be modeled. Just as carriers cannot build in advance to a particular standard and be profitable, a cost modeler cannot model a special access network without detailed information on customers' specialized demands at various locations.

application of those cost models spawned enormous litigation over every conceivable aspect of UNE pricing, from such fundamental issues as the appropriate use of hypothetical or historical costs to the individual components of the model, including available technology, structure sharing, fill factors, cost of capital, depreciation, expenses, and non-recurring charges.[130] The end result of these years of litigation, however, was not consensus but deepening uncertainty; as the Commission put it, "the TELRIC rules have proven to take a great deal of time and effort to implement, and have been the subject of extensive criticism."[131] Thus the Commission launched a new rulemaking in 2003 calling for a fundamental rethinking of the TELRIC methodology – a proceeding which generated yet another extensive record and which remains pending today.[132] Any attempt to develop cost models for special access services from scratch would raise all of the same issues and would thus inevitably result in years of costly and completely unnecessary proceedings and litigation.[133]

And even after lengthy proceedings, such cost models would inevitably produce arbitrary results. The reality is that many special access costs are joint and common costs associated with

[130] The Commission described this litigation: "State pricing proceedings under the TELRIC regime have been extremely complicated and often last for two or three years at a time. State commissions typically are presented with at least two conflicting cost models, and hundreds of inputs to those models, all supported by the testimony of expert witnesses. These cases are extremely complex, as state commissions must make dozens of detailed decisions . . . . The drain on resources for the state commissions and interested parties can be tremendous. We also note that, for any given carrier, there may be significant differences in rates from state to state, and even from proceeding to proceeding within a state." *TELRIC NPRM*, 18 FCC Rcd. 20265, ¶ 6.

[131] *Id*.

[132] *See id.* ¶¶ 1-9.

[133] The Notice seeks information on "projected costs per customer" to deploy the facilities necessary to provide its U-verse video and other broadband services. But these facilities are being deployed primarily in residential areas, and not commercial areas where there is appreciable special access demand and the costs associated with the U-verse project, accordingly, have little, if any, relevance in this proceeding. In any event, projecting "costs per customer" would require predictions about success and penetration of the new services, which would be wildly premature given that the service is just being rolled out.

a wide range of services provided over the same network facilities; the price cap LECs' special access services are provided almost entirely over the same fiber interoffice transport and loop feeder facilities that are used to provide essentially the full range of LEC services. As the Commission has repeatedly acknowledged, "economic theory does not provide a clear answer to the question of how joint and common and fixed costs should be allocated for costing purposes" and "[t]his is particularly problematic in the telecommunications industry due to the very high proportion of joint and common costs and fixed costs."[134] Indeed, the Commission has recognized that the problem of properly assigning joint and common costs is much more difficult in the context of determining prices for services (such as access services) than it is even in the context of determining prices for unbundled network elements (which are intended to be merely the rental of facilities).[135] For these reasons, any estimate of special access costs would be inherently arbitrary and extremely difficult to explain or defend.

Nor would the Commission's difficulties end there. The Commission's existing authorized rate of return of 11.25 percent is woefully out of date, and the Commission would also have to undertake substantial proceedings to determine a rate of return appropriate to this market. The Commission established the current 11.25 percent rate of return in 1991, prior to the implementation of the LEC price cap regime.[136] Even the most die-hard advocates of special access re-regulation would have to admit that special access is vastly more competitive today

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[134] *Review of the Section 251 Unbundling Obligations*, 18 FCC Rcd 19020, ¶ 157 n.515 (2003); *see also Implementation of the Local Competition Provisions of the Telecomms. Act of 1996*, 11 FCC Rcd. 15499, ¶ 678 (1996) ("*Local Competition Order*") (it is "difficult for regulators to determine an economically optimal allocation of any such joint and common costs").

[135] *Access Reform Order*, 12 FCC Rcd. 15982, ¶ 45; Notice of Proposed Rulemaking, *Access Charge Reform Price Cap Performance Review for Local Exchange Carriers*, 11 FCC Rcd 21354, ¶ 237 (1996); *Local Competition Order*, 11 FCC Rcd. 15499, ¶¶ 678, 827.

[136] *LEC Price Cap Order*, 5 FCC Rcd 6786, App. F ("Beginning January 1, 1991, carriers must reflect the 11.25 percent rate of return in both their price cap index levels and their rates").

than it was in 1991, when only a handful of "CAPs" (competitive access providers, as they were then called) had established networks in a few cities (and were still trying to convince the Commission to mandate physical collocation). LECs today face far greater competitive risks, which means that they must be able to earn much higher returns that reflect those risks.

Moreover, the Commission has never adopted a rate of return for a specific service. Rather, rate of return regulation has applied on an enterprise basis to all of a carrier's interstate services. As carriers of last resort, BOCs are required to provide a full complement of services, many at intentionally cross-subsidized prices. Hence the Commission could not lawfully prescribe a rate of return for special access services without taking into account the impact of that prescription on carriers' overall rates of return and without ensuring that carriers have the opportunity to earn an appropriate overall return. Determining the appropriate rate of return thus would entail another enormously complex and extensive regulatory proceeding and, a largely arbitrary judgment call.[137]

[137] The Commission could not avoid these obstacles by attempting to determine special access costs on the basis of historical costs as reported in ARMIS. As explained in Section II above, the Commission has not used ARMIS for any ratemaking purpose in years, and because of the separations freeze ARMIS-reported data becomes increasingly inaccurate every year. Indeed, ARMIS was *never* intended to be used to determine service-specific costs or returns, and thus any use of ARMIS data to determine special access costs would be indefensible.

CONCLUSION

For the foregoing reasons, the Commission should reject proposals to further regulate special access services and should adopt the additional deregulatory proposals set forth herein and in AT&T's initial and reply comments.

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August 8, 2007

ATTACHMENT TO
SUPPLEMENTAL COMMENTS OF AT&T INC.

(SUPPLEMENTAL DECLARATION OF PARLEY C. CASTO)

***** REDACTED FOR PUBLIC INSPECTION *****

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the matter of	)	
	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
	)	
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Access Services	)	RM-10593

SUPPLEMENTAL DECLARATION OF PARLEY C. CASTO
ON BEHALF OF AT&T INC.

I. WITNESS IDENTIFICATION AND QUALIFICATIONS.

1. My name is Parley C. Casto. I am the same Parley Casto that filed declarations on behalf of SBC Communications Inc. ("SBC") in this proceeding on June 13, 2005 and July 29, 2005.

2. My title is Assistant Vice President – Strategic Pricing – AT&T Business Marketing for AT&T Inc. ("AT&T"). I am responsible for all aspects of pricing for AT&T Wholesale products and services to interexchange carriers, wireless customers, content providers, CLECs and ISPs.

3. My previous positions included Sales Vice President for AT&T Wholesale and Executive Director – Industry Markets Special Access Product Management for SBC. In the latter position, I was responsible for product management, rate development, policy development, and tariff management for the wholesale special access business of SBC on an enterprise-wide basis. Prior to holding these positions, I served as Director of various other product management organizations within SBC. In those positions, I supervised product management teams responsible for switched access, advanced services, and certain transport

(special access and unbundled network element). I also was responsible for SBC enterprise-wide product development, rate development, and company policy for these products.

4. I received my BA from DePaul University in Chicago, Illinois in 1999 and my MBA from DePaul University in 2002. I also earned a Telecommunications Certificate on telecommunications traffic management and engineering from DePaul University's School of Computer Science, Telecommunications and Information Systems. I began working for Illinois Bell Telephone Company in 1992 in the network services organization in Chicago, Illinois.

II. PURPOSE AND SUMMARY OF DECLARATION.

5. The purpose of this declaration is to supplement the evidence I presented in 2005 demonstrating that AT&T faces intense competition for special access services from a very large number of competitors, and that AT&T has continued aggressively to meet that competition with lower prices, more network investment, and more innovative service offerings. As demonstrated below, CLECs continue to mature, consolidate, and dramatically expand their fiber networks in all areas with appreciable special access demand, and analysts report that CLEC competition for wholesale private line services rates a "9" out of a possible "10"."[1] At the same time intermodal competition, particularly from cable and broadband wireless providers, has exploded for DS1 and higher capacity services in remote and dense areas alike, thus further intensifying competition for private line/special access services in all areas.

III. AT&T CONTINUES TO FACE STIFF COMPETITION FROM FACILITIES-BASED PROVIDERS OF SPECIAL ACCESS ALTERNATIVES.

6. I documented in my 2005 declarations the intense special access competition from numerous sources that AT&T faces in every geographic area where there is appreciable special

[1] *North American Wholesalers Private Line Services Markets*, Report by Frost & Sullivan, at 1-11 (2007).

access demand. I showed that traditional wireline CLECs have deployed their own fiber to blanket the downtown, office park, and other dense commercial areas where special access demand is concentrated. Consequently, the majority of DS1 and DS3 circuits that AT&T sells could readily be supplied by these CLECs over their existing fiber building connections or with short extensions (a few blocks or less). I also documented the competition that AT&T faces from intermodal cable and wireless providers, which as of 2005 was rapidly growing and already beginning to exert significant competitive pressure. Further, I demonstrated that AT&T had responded to this competitive pressure by lowering prices and taking other steps to meet its customers' specialized needs.[2]

7. In the past two years, the competitive pressures in the special access market have only increased. Through both consolidation and expansion, the CLEC industry has grown even stronger. The geographic scope of CLEC fiber networks has significantly expanded, and as a result even more commercial buildings are connected or very close to CLEC fiber. In fact, I am not aware of any significant commercial area where AT&T does not face facilities-based special access competition today.

8. Perhaps the most remarkable developments in the past two years, however, relate to the explosion of intermodal competition. The stream of intermodal entry I documented in 2005 has become a raging river with increases in customer bandwidth requirements, the development and deployment of new wireless technologies, and the focus on business services by large cable operators that, particularly outside core downtown areas, often have high capacity fiber or coaxial facilities closer to commercial end user premises than AT&T and other price cap LECs do. These new developments are particularly significant in this proceeding because these

[2] I also explained in my 2005 declarations that CLECs were then providing intense competition for OCn level services everywhere, and they continue to do so today.

intermodal competitors have aggressively targeted DS1 and DS3 demand, including demand at relatively remote locations such as cellular towers, that often has been a focus of advocates of increased regulation.

9. Throughout MSAs of all sizes and types, including those with Phase II pricing flexibility and those that remain subject to price caps, AT&T competes with many strong facilities-based providers. That undeniable reality means that my team and others at AT&T are constantly looking for ways to provide special access services to our customers more efficiently, at lower cost and higher quality, and in ways that are better tailored to customers' individual and diverse needs.

A. COMPETITORS HAVE CONTINUED TO DEPLOY FIBER IN THE AREAS WITH APPRECIABLE SPECIAL ACCESS DEMAND.

10. In 2005, my declaration provided an analysis of the proximity of known CLEC fiber to AT&T's DS1 and DS3 demand in 10 MSAs in the 13-state SBC region. At my direction, AT&T has analyzed 5 additional MSAs: Atlanta and Miami, which are the two BellSouth Phase II channel termination MSAs examined by the GAO in its recent report, and Austin, Columbus, Ohio, and San Jose, three Tier II MSAs in the 13-state SBC region. **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** of AT&T's demand for both DS1 and DS3 services in those 5 MSAs is either already connected to or within 1000 feet (or about three blocks) of known CLEC facilities. This pattern of highly concentrated special access demand is very typical within AT&T's service territory, and competitive providers have built alternative fiber networks in these dense commercial areas to serve these customers.

11. Of course, there are many commercial buildings, including many single tenant buildings, in which alternative providers already serve *all* of the customer demand for special access services. Because these types of CLEC-served buildings are not reflected in my analysis,

which examines the proximity of *AT&T* demand to CLEC fiber, the analysis substantially understates the share of total special access demand that is immediately addressable by traditional fiber-based CLECs. My analysis is also understated because it does not examine the level of demand within a building. Consider the following example. Suppose building A has demand for ten DS3 circuits, and that AT&T serves one of those circuits and CLECs serve the other nine. Further suppose that building B has demand for one DS3 circuit and that AT&T serves that demand. And suppose that there is no CLEC fiber anywhere near building B. My analysis would show that CLECs can serve 50 percent of AT&T's demand because they have fiber at or near building A (where AT&T provides one DS3), but not building B (where AT&T also provides one DS3). CLECs are in fact able to serve nearly 90 percent of the total demand in these two buildings (nine out of the eleven circuits in buildings A and B combined). Thus, while the analysis above confirms that CLECs can serve the majority of AT&T's special access demand, CLECs can in fact serve a much larger portion of the overall special access demand.

12. The fiber maps for the five new MSAs also confirm that CLECs have continued to maintain and deploy alternative fiber facilities. In each of the 5 sample MSAs, these fiber maps show in shaded areas the wire centers that account for more than 80 percent of AT&T's DSn level demand in the MSAs, and demonstrate that the fiber networks deployed by CLECs continue to blanket the areas that comprise the vast majority of AT&T's special access demand. Further, these competitors continue to be collocated in the AT&T wire centers that serve appreciable special access demand. These maps also show that there are numerous carrier hotels

where CLECs place competitive facilities that are not captured by the current competitive pricing flexibility triggers.[3]

13. It is also important to recognize that in the vast majority of wire centers – usually exceeding 90 percent of wire centers – in MSAs subject to pricing flexibility are considered "impaired" wire centers for DS1 and DS3 loops, and thus incumbents are required to provide DS1 and DS3 UNE loops and transport at below cost TELRIC rates to competitors at locations served by these wire centers.

14. In addition to these empirical analyses, it is clear just from industry analyses and the CLECs' own press releases in the past two years that CLECs have added thousands of fiber miles and building connections to their networks. In addition, through consolidation they have strengthened their market positions. For example, Level 3 now has completed acquisitions of WilTel, Progress Telcom, Telcove, Looking Glass, ICG Communications, and Broadwing.[4] In each case, the acquisition greatly expanded Level 3's fiber network and the number of buildings

[3] As I previously explained, there is no particular magic to an analysis based on a 1000-foot distance. However, AT&T's estimates suggest that it generally would be relatively inexpensive and wholly cost effective for a competitor to extend a fiber drop 1000 feet to access DS1 or DS3 demand and then rely on existing competitive fiber for the rest of the route. As I explained in my 2005 declarations, the cost then for a competitor to extend 1000 feet of fiber to access this demand, including any construction, splicing, inter-duct, and testing (assuming there is available bandwidth on the existing competitive fiber) ranges from about **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** on average if conduit already exists and up to about **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** on average in downtown areas where conduit does not exist (because such construction would require digging up sidewalks and streets). And since most DS1 and DS3 demand in dense downtown areas is fairly centralized, this one-time investment would be a highly cost-effective means of serving many potential customers. For these reasons, existing competitive fiber deployment represents not only actual, but very real potential, competition for AT&T's special access business. Since 2005, the costs of equipment and fiber used by CLECs to provide special access alternatives have declined, and their costs of extending their fiber have therefore likely declined as well.

[4] Level 3, SEC Form 10-Q, at 38 (filed May 10, 2007), available at http://lvlt.client.shareholder.com/sec.cfm?DocType=Annual,Quarterly.

connected to that network. Level 3 further expanded its network with 1,600 miles of metropolitan fiber with connections to 200 buildings with facilities divested by AT&T and purchased by Level 3 in connection with the AT&T/SBC merger.[5] As of April, 2007, Level 3 reports having more than 25,000 route miles of fiber and connections to more than 6,500 buildings throughout the country.[6]

15. Likewise, Time Warner Telecom informed investors in 2006 that its "primary objective" was to be a "leading provider of high quality managed data and telecommunications services in each of our service areas, principally utilizing our fiber facilities and our national IP backbone network to offer high value voice, data, Internet, and dedicated services to become the carrier of choice for . . . business enterprises, governmental agencies, and other carriers."[7] To this end, Time Warner Telecom acquired Xspedius Communications, thereby expanding its fiber footprint to 75 markets.[8] Time Warner also added facilities obtained from AT&T in connection with AT&T's divestiture of channel terminations and transport that were conditions of the AT&T/SBC merger. These acquisitions, along with Time Warner Telecom's other capital investments, increased Time Warner's Telecom "fiber network by approximately 4,000 route

[5] Denise Pappalardo, Other Carriers Benefit From AT&T, Verizon Acquisitions; Level 3 and AboveNet pick up Divested Assets, Network World (April 4, 2007), available at http://www.networkworld.com/news/2007/040407-att-verizon.html. Level 3 Press Release, Level 3 Completes Purchase of AT&T Divestiture Assets (April 4, 2007), http://www.lvlt.com/newsroom/pressreleases/2007/20070404.html.

[6] *Id.*

[7] Time Warner Telecom, Annual 10-K Report, at 3 (March 2006).

[8] *Id.* Time Warner Press Release, Time Warner Telecom Closes Xspedius Communications Acquisition (Nov. 1, 2006), available at http://www.twtelecom.com/news_info/twtc_news_06.html.

miles and into approximately 1,500 additional buildings."[9] Time Warner Telecom now has nearly 8,000 on-net buildings.[10]

16. XO, in addition to the growth associated with Nextlink, its broadband wireless subsidiary (discussed below), has continued to grow its wireline fiber network. XO announced, for example, that it has engaged in "significant expansion in the availability of XO Ethernet services," such that it can now provide such services in more than 60 metropolitan markets.[11] In February, XO announced a new initiative whereby it "guarantees [to] offer any large enterprise and wholesale customer to beat valid competing offers for comparable high-capacity network services."[12] To meet the anticipated demand associated with this program, XO has been "deploy[ing] additional capacity across its nationwide network."[13] Further, much of this capacity has been deployed in carrier hotels, thus evading detection by the special access competitive triggers.[14]

17. Other CLEC competitors also have continued to expand their network footprints through capital investments. Abovenet, for example, reports that it now has over 1.5 million fiber miles serving more than a dozen large metropolitan areas with more than 1,300 lit buildings, as a result of internal expansion and the purchase of facilities divested by AT&T and

[9] *Id.* at 2-3.

[10] *Id*.

[11] Press Release, XO Expands National Ethernet Services Footprint (Mar. 20, 2006), available at http://www.xo.com/new/293.html.

[12] XO Press Release, XO Communications Announces Nationwide Network Services Campaign for Large Enterprises and Service Providers (February 28, 2007), available at http://www.xo.com/new/330.html.

[13] *Id.*

[14] *Id.*

Verizon in connection with their recent mergers.[15] US Signal, which has built one of the most comprehensive fiber networks in the Midwest, expanded its network in Milwaukee, Chicago, and several other cities in Indiana in 2007.[16] And Neon, a subsidiary of Globix Corporation that operates a fiber network in the Northeast and mid-Atlantic regions, added 16 new points-of-presence to its network in 2006 and is expanding to the Long Island and greater Philadelphia markets during 2007.[17] In fact, RCN recently acquired Neon, claiming that Neon offered "a complementary network and a customer base that fits very well into RCN Business Solutions' growth strategy."[18] The proposed combination would "nearly double [its] revenue in [the] lucrative Northeast Corridor and Chicago markets" and would allow RCN to "add[] scale" and "network reach."[19]

18. A recent 2007 industry analyst report assessing wholesale private line services states that, on a scale of 1 to 10, "the degree of competition is expected to be 9" in the private

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[15] *See* Press Release, AboveNet, Inc., *AboveNet Acquires Metro Fiber from AT&T and Verizon* (Apr. 4, 2007), available at http://www.abovenet.com/newsandevents/pressreleases/pr070404.html; About Abovenet, http://www.abovenet.com/about.

[16] *See* Press Release, US Signal, *US Signal Announces Major Metro Market Expansion to Milwaukee, Lights Northbrook and La Grange, Illinois Network Nodes* (Jan. 2, 2007), available at http://ussignalcom.com/cmsFiles/pressReleases/1173900917_jan%2007%20milwaukee%20expansion.pdf; Press Release, US Signal, *US Signal Announces Metro Market Expansion in Chicago, Illinois*, (June 26, 2007), available at http://ussignalcom.com/cmsFiles/pressReleases/1182964598_chicago%20expansion%2006%202607.pdf; Press Release, US Signal, *US Signal Announces Further Expansion in Indiana* (Apr. 9, 2007), available at http://ussignalcom.com/cmsFiles/pressReleases/1176214342_southern%20indiana%20040907%20_2_.pdf.

[17] *See* Press Release, *Optical Network to Expand Into Long Island and Greater Philadelphia Markets* (Jan. 18, 2007), available at http://www.neoninc.com/pages/100_neon_continues_to_expand_its_optical_network.cfm.

[18] *See*, Press Release, *RCN to Acquire NEON Communications Group for up to $5.25 Per Share*, (June 25, 2007), available at http://investor.rcn.com/ReleaseDetail.cfm?ReleaseID=250812.

[19] *Id.*

line market.[20] The report explains that "[e]ven though the private line market has been witnessing consolidation during the last three years, the number of competitors [about 45 according to the report] still continues to be high."[21] In addition to detailing the large number of wholesale private line competitors, the report also accurately describes the "stiff competition" from other wireline technology, including Ethernet-based and Wavelength services, that can often provide the same services at much lower cost.[22]

19. In addition to this publicly available information, data provided by CLECs to AT&T further confirms that CLECs have continued to significantly expand their networks. In particular, CLECs that seek to sell wholesale special access services to AT&T's long distance unit periodically provide to AT&T lists of buildings to which they already or can easily provide dedicated services. Comparing the current CLEC lists to those provided to AT&T a year or two ago confirms that facilities-based CLECs have significantly expanded the scope of their networks and on-net building portfolios in the past two years. For example, the number of "lit" buildings reported to AT&T by some of these CLECs has increased by 20 percent or more since 2005.

20. While all available data confirm the intense wireline CLEC competition to AT&T's special access services, both the fiber maps generated from publicly available information and the collocation data used by the Commission to measure competition substantially *understate* the actual amount of competitive fiber and activity in any given area.

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[20] *North American Wholesalers Private Line Services Markets*, Report by Frost & Sullivan, at 1-11 (2007); *see also id.* at 1-28 ("With over 45 competitors, the degree of competition within the wholesale private line market is highly intense. The local access market has a degree of competition which his even more intense. That market is dominated by small, medium and large sized players").

[21] *Id.*

[22] *Id.*

Throughout this proceeding, CLECs have chosen to not supply the Commission with any specific information about the locations and extent of their facilities and competitive activity. Consequently, the fiber maps and demand/fiber proximity calculations prepared under my direction must necessarily rely upon information obtained from third party sources such as GeoTel, which compile information from high level surveys of a subset of CLECs and from various publicly available sources such as city construction permits. While the fiber identified by GeoTel unquestionably has been deployed, it is far from all of the competitive fiber in use today. When AT&T has obtained actual fiber route data from individual CLECs, those data confirm that the GeoTel data is incomplete and generally identifies only a subset of the fiber that actually has been deployed by the CLEC.[23] The underinclusiveness of publicly available data on alternative facilities was also demonstrated in connection with the SBC-AT&T and AT&T-BellSouth merger proceedings. There, AT&T conducted physical, on-site inspections of hundreds of commercial buildings and their environs. These inspections confirmed the existence of very substantial amounts of CLEC fiber that was not reported in any publicly available source. Additionally GeoTel generally does not track the extensive fiber networks of cable companies, which in recent years have spent billions of dollars to expand and upgrade both their fiber and hybrid fiber-coaxial networks to be able to carry business and wholesale carrier class data and voice services on their networks. Further, GeoTel does not account for broadband wireless networks, which, as detailed below, have been deployed on a broad basis since my last declaration. Collocation data likewise dramatically understate the actual level of competition because they do not reflect the substantial number of competitive alternatives that rely on

[23] Another way that I have been able to confirm that GeoTel understates the availability of competitive alternatives is that there are numerous wire centers throughout the AT&T territory where CLECs have obtained fiber-based collocation and where fiber clearly exists, yet GeoTel does not identify this fiber.

facilities that bypass AT&T's wire centers and that, for example, connect to AT&T indirectly through carrier hotels.

21. I am sure that this additional evidence of widespread facilities-based competition will be met with complaints that there still is not enough competition, because not every single commercial building is or readily could be immediately supplied by a wireline CLEC today. These complaints are red herrings. Foremost, they ignore the availability of the burgeoning cable and broadband wireless solutions that, as I discuss below, are tailor-made to address locations, such as cell tower and other locations, that may be remote and may have relatively lower demand. More fundamentally, however, these complaints misunderstand the competitive pressures and marketplace realities. Customers located in buildings where there may be fewer or no competitive alternatives to AT&T's special access pricing get the full benefits of the intense competition that exists in most other areas. This is because AT&T provides special access under tariffs and contracts that are available to any similarly-situated customer within each particular MSA, state or region. It would be impractical for AT&T to set its prices for its services on a building-by-building basis. Consequently, price decreases designed to meet competition in areas with the largest number of competitive alternatives are generally available to *all* customers in that area, regardless of the number of competitors serving any particular customer.

B. BROADBAND WIRELESS AND CABLE SPECIAL ACCESS COMPETITION HAS SUBSTANTIALLY INCREASED SINCE 2005.

22. In 2005, based on publicly available information and internal data from AT&T's competitive experiences, I reported that broadband wireless and cable providers were becoming serious special access competitors to AT&T. Today, I can now report that these intermodal competitors are firmly established as substantial competitors. In addition, unlike traditional fiber-based CLEC providers that have most heavily focused their deployment in the downtown

and office park areas where special access demand is most concentrated, this new breed of competitors is targeting not only those areas, but also the suburban and even rural areas where many smaller business and wireless telephone cell sites are located. These carriers have been ready and willing to provide DS1 and DS3 services, and are capable of providing advanced OCn level services. Notably, I can report that, outside of its local service area, AT&T itself now purchases literally thousands of DS1 and DS3 circuits from broadband wireless companies (including FiberTower and TTMI) and cable companies (including Comcast, Time Warner, Cox and Cablevision). My own business experience also confirms that cable and wireless providers are firmly established in the market: AT&T's special access customers constantly remind AT&T that they can turn to these alternatives and, if AT&T wants to retain their business, AT&T must be willing to ensure that its prices and services remain competitive.

23. **Broadband Wireless.** In the case of broadband wireless carriers, their ability to provide cost-effective DS1, DS3, and higher capacity services just about anywhere derives from the fact that broadband wireless services can be deployed to most locations without the need to lay fiber. These technologies are deployed using antennae, usually attached between the rooftops or windows of the customer buildings receiving the service and another building connected to a CLEC, ILEC or other carrier's fiber network. Equally as important, this deployment can occur in as little as 24 to 48 hours – far less than the four to six weeks required to build a conventional wireline circuit. Fixed wireless services also are highly flexible. They can be installed on a temporary basis and bandwidth can be scaled with demand. Prior limitations on fixed wireless, such as distance and line of sight, are being overcome by new technologies, such as WiMAX, which does not require clear lines of sight and has a potential coverage area that spans 30 miles with little regard to topography.

24. Given these characteristics, it is not surprising that industry analyses and the broadband wireless providers' own materials confirm that they are providing service at all levels and in all areas. For example, FiberTower Corporation is a company that provides wireless broadband backhaul, principally to mobile carriers, in competition with LECs. In 2006, FiberTower Corporation expanded by merging with First Avenue Networks. FiberTower, the combined company, now "provides mission and business critical transport solutions, including backhaul and premise access services, to major wireless carriers, enterprises and government agencies."[24] It offers "carrier-grade performance, point-to-point and point-to-multipoint capabilities, and TDM to Ethernet service platforms,"[25] including "wireless equivalents of []T1, DS3, OC3 and Carrier Ethernet."[26] In addition to providing service to "leading wireless carriers" and "enterprise and government partners" in many of the leading metropolitan areas,[27] FiberTower owns wireless spectrum throughout the country and continues to rapidly expand its network to serve virtually any location. Indeed, FiberTower was recently "selected to participate in" a massive government contract, whereby "FiberTower will bring fixed-wireless services to individual government agencies" "[u]tilizing [its] national-scope government-grade wireless transport services."[28] FiberTower reports that in the first quarter of 2007, its billing sites grew 19 percent and its billing customer locations grew by 22 percent.[29] In addition, FiberTower recently

[24] FiberTower Corp. – About FiberTower, http://fibertower.com/corp/company.shtml.

[25] *Id.*

[26] FiberTower Corp. – Access, http://fibertower.com/corp/solutions-access.shtml.

[27] These areas include DC Metro, Boston, Chicago, Cleveland, Dallas/Fort Worth, Denver, Detroit, Houston, NJ/NY, Pittsburgh, San Antonio/Austin/Waco, Tampa, Atlanta, and others. *See* FiberTower Corp. – About Fiber Tower, http://fibertower.com/corp/company.shtml.

[28] FiberTower Corp. – Gov't, http://fibertower.com/corp/solutions-government-networx.shtml.

announced "that it had entered into a agreement with Sprint Nextel . . . to provide backhaul services in seven of the wireless carrier's [Sprint Nextel's] initial WiMax launch markets."[30] And, I further understand that FiberTower provides substantial wireless backhaul services to T-Mobile.

25. Similarly, TTM Inc. ("TTMI"), uses broadband wireless facilities to meet the increasing backhaul requirements of wireless telephone providers.[31] TTMI will deploy a connection to virtually any building upon request. AT&T Mobility already purchases thousands of DS1 and DS3 circuits from TTMI for backhaul, and I understand that it is in the process of negotiating the purchase of even more circuits from TTMI.

26. XO Communications, a carrier with a very large fiber network, has also greatly expanded its broadband wireless presence. XO is one of the nation's largest holders of fixed wireless spectrum,[32] and XO now provides broadband wireless services through its new subsidiary Nextlink. According to Nextlink, "[t]he Nextlink fixed wireless spectrum footprint covers 95% of the population in 75 of the top markets in the United States."[33] Nextlink offers wireless metro private line service at all bandwidths as well as wireless metro Ethernet service at

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[29] News Release, FiberTower, *FiberTower Reports First Quarter 2007 Results* (May 8, 2007), available at http://www.fibertower.com/corp/downloads/press_releases/FT_Q107_Earnings_Release.pdf.

[30] Press Release, *FiberTower Announces Backhaul Agreement With Sprint Nextel for WiMax Buildout* (August 1, 2007), available at http://www.fibertower.com/corp/news-press-releases-080107.shtml.

[31] *See* Telecom Transport Mgmt., http://www.ttmi.info/index.htm.

[32] Casto Initial Decl. ¶ 47.

[33] *See* About Nextlink, http://www.nextlink.com/about_nextlink.htm.

speeds up to 100 Mbps.[34] Nextlink's president and CEO stated that Nextlink "operates the nation's largest broadband wireless network in the U.S." and can offer its customers and reseller partners "access to more than five million business locations with a wide range of scalable bandwidth options."[35] Nextlink "anticipates expanding its market presence to many more major U.S. cities by the end of 2008."[36] Just last month, on July 11, 2007, XO and Nextlink announced that they had expanded their "broadband wireless service to 24 new . . . markets [and can now] provide alternative last mile connections to service providers" in those markets.[37]

27. First Mile Communications is another company that provides what it calls an "industry-leading" service level agreement, in which it offers installation in as little as a week.[38] In July 2007, First Mile, partnering with Southern Telecom, announced significant expansion in Atlanta's downtown and midtown areas.[39] The companies stated in the announcement that they are "aggressively expanding their Wireless Lateral service into a greater number of Class A office buildings in the Atlanta metro area."[40]

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[34] *See* Nextlink, Wireless Access for Communications Carriers, http://nextlink.com/livefiles/ServiceGroups/1/Service_Providers.pdf; Nextlink Services, http://www.nextlink.com/services.htm.

[35] Press Release, Nextlink, XO Communications Expands Broadband Wireless Coverage to 36 Markets (July 11, 2007), available at http://www.nextlink.com/news_71.htm.

[36] *See* http://nextlink.com/livefiles/ServiceGroups/1/Service_Providers.pdf.

[37] Carol Wilson, XO Expands Broadband Wireless To 36 Markets, TelephonyOnline (July 11, 2007), available at http://telephonyonline.com/home/news/xo_broadband_wireless_071107/index.html.

[38] *See* First Mile Communications, http://www.firstmile.com/50/First_Mile_Broadband_Benefits.htm.

[39] *See* Press Release, Southern Company, *First Mile Communications and Southern Telecom light eight major Atlanta office buildings* (July 12, 2007), available at http://pressroom-publisher.southerncompany.com/telecom/telecom13.html.

[40] *Id.*

28. As I noted in my prior declarations, WiMAX technology – a new technology that overcomes line-of-sight issues and that has a range of nearly 30 miles – was in 2005 just beginning to be deployed. Towerstream now offers on a widespread basis wireless broadband services using WiMAX technology at speeds up to 1,000 Mbps in several major metropolitan areas, including New York City, Boston, Providence, Newport (RI), Chicago, San Francisco and Los Angeles.[41] It is marketing its service as a cost effective substitute for traditional wireline special access services (such as DS1 and DS3 services) with rigorous service quality guarantees. Towerstream also promises to deliver its services within days or hours, rather than the weeks required to deploy wireline special access services. And Towerstream is quickly expanding the reach of its network.[42]

29. These broadband wireless companies are only the tip of the iceberg. For example, one Internet service, called "T1 Shopper" (http://www.t1shopper.com) identifies dozens of other

[41] Casto Initial Decl. ¶¶ 50-52.

[42] For example, in June 2007, Towerstream announced plans to expand its San Francisco broadband network to include the Oakland metro area. Press Release, Towerstream, *Towerstream To Expand San Francisco Network Offering High Speed Wireless Broadband to Additional Area Businesses* (June 18, 2007), available at http://www.towerstream.com/content.asp?pc:85. Towerstream expects to bring new customers on-line in July 2007. In February 2007, it announced plans to expand its Los Angeles network to include the Century City commercial district, which include many important film, television and music industry businesses. Press Release, Towerstream, *Towerstream Expands Los Angeles Network Offering High Speed Wireless Broadband to Additional Area Businesses* (Feb. 14, 2007), available at http://www.towerstream.com/content.asp?pc:70. In announcing this expansion, Towerstream's President and CEO stated that the company is "committed to deeper penetration in our major metropolitan markets and adding additional cities throughout 2007." *Id.* In addition, in March 2007, Towerstream announced the launch of its wireless broadband solution in the Miami metropolitan area. Press Release, Towerstream, *Towerstream Launches Fixed WiMAX Network in Miami* (Mar. 13, 2007), available at http://www.towerstream.com/content.asp?pc:73.

local, regional and national suppliers of DS1 and DS3 equivalent dedicated services available to small businesses and wholesalers.[43]

30. **Cable Companies.** As I demonstrated in my prior declarations, cable companies have widespread fiber-based networks throughout the areas where special access demand is most concentrated. In addition, because cable companies have widespread fiber and coaxial networks that blanket nearly all locations where people live or work, cable companies can and do provide all levels of service, including DS1 and DS3 service, throughout the country. Even in 2005, more than **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** of the retail DS1 circuits AT&T lost to competitors were lost to cable service providers.

31. I provided several examples in my original declarations of the substantial competition by cable companies with respect to special access services. This threat has increased, as cable companies continue to expand their offerings and to introduce new services, particularly to small and medium-sized businesses. Indeed, industry analysts consistently emphasize the significant opportunities for cable companies in the small and medium-sized business market.[44] By all accounts, cable companies are moving aggressively to take full advantage of these opportunities.[45]

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[43] Wireless T1 Service Provider Directory, http://www.t1shopper.com/carriers/wireless.

[44] *See, e.g.*, Tim McElgunn, Pike & Fischer, *Cable Commercial-Services Strategies*, at 4 (May 2007) ("Pike & Fischer has no doubt that the largest [cable] MSOs and many smaller operators will indeed achieve meaningful and rapid penetration into the $65 billion annual SMB revenue stream"); Sterling Perrin, Heavy Reading, *Cable vs. Telcos: The Battle for the Enterprise Market*, at 12 (Feb. 2006) ("*Heavy Reading*") ("SMEs – roughly speaking, companies employing between 10 and 499 people – are widely seen as the market sweet spot for the [cable] MSOs"); The Insight Research Corporation, *Cable Telephony: The Threat To Small Business ILEC Markets, 2007-2012* (April 2007).

[45] *See, e.g.*, Bob Wallace & Paula Bernier, *Cablecos Voice their Business Strategies* (June 21, 2007), available at http://www.newtelephony.com/news/76h20193231.html ("*Wallace &*

32. I described in my earlier declarations the rapidly growing penetration of Cox Cable in telecommunications markets, including telephony and wholesale/enterprise services such as point-to-point and dedicated ring special access connections at bandwidths of DS1 to OC48, and even OC192 in some markets.[46] Cox also offers 100 Mbps and 1 Gbps Ethernet services in certain of its markets. Cox markets these services to large business customers, as well as to wholesale customers, including carriers, ISPs, and wireless providers.

33. Cox reports that it provides service to "more than 100,000 business customers" in "more than 36 markets, from California to New England."[47] Moreover, a significant portion of Cox's customers are small and medium sized businesses located in areas outside the densely populated downtown areas, and market share is growing at double digit rates annually.[48] Cox has continued to aggressively expand its offerings during the past two years. For example, in March 2007, Cox announced that it is expanding its service area to downtown Los Angeles by

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Bernier") ("Having established beachheads in many local markets, the five largest U.S. cablecos are launching a new offensive to attack the unprotected flank of incumbent telcos, and secure SMB customers"); *see also id.* ("The big five cablecos note that SMBs provide fatter margins than do residential customers, boast larger ARPU [average revenue per unit] and lower churn rates"); Peter Grant, The Wall Street Journal Online, *Cable Firms Woo Business In Fight for Telecom Turf* (Jan. 18, 2007), available at http://startup.wsj.com/runbusiness/relationships/20070118-grant.html?refresh=on ("Some cable-industry executives predict there are billions of dollars of new revenue to be made from serving business clients.").

[46] Casto Initial Decl. ¶¶ 38-40. Cox characterizes its network as "[t]housands of miles of fiber-optic cable . . . designed with a self-healing, fault-tolerant SONET backbone for enhanced dependability, plus highly fault-tolerant ringed architectures in local service areas." *See* Cox Business Services, http://www.coxbusiness.com/products/other/commercial.html. It describes its private line service as "a SONET-based, point-to-point private line network service that provides a clear, reliable high-speed connection for stand-alone or integrated voice, data, and video communications between locations." *See* Cox Private Line, http://www.coxbusiness.com/pdfs/CBS40200-PrvtLn_DS0605.pdf.

[47] *See* Cox Business Services, http://www.coxbusiness.com/aboutus/index.html.

[48] *See, e.g., Wallace & Bernier.*

offering high-capacity data transport and Internet services.[49] With this expansion, the 12,600 businesses in south and central Orange county that purchase the company's commercial broadband and telecom services can connect their businesses and information systems to locations in Los Angeles entirely on the Cox network.[50] Cox is promising installation in as little as a week to 30 days, in comparison to the 45 days to 6 months required by traditional telecom companies.[51]

34. CableVision likewise is actively marketing business services through its Optimum Lightpath subsidiary. Optimum Lightpath boasts of an expansive fiber-to-the premises network of 2,500 route miles that lights over 2,000 commercial buildings in New York, New Jersey and Connecticut, and passes more than 137,000 additional commercial buildings, with the vast majority in suburban areas.[52] It offers a variety of Ethernet-based voice, data and internet services including high-bandwidth point-to-point, hub-and-spoke, and multipoint-to-multipoint services.[53] Optimum Lightpath is achieving significant penetration in this tri-state market. For example, according to the company website, more than 50 percent of the municipalities in New York's Westchester County use its advanced communications solutions.[54] In addition, more than 15 healthcare providers in this tri-state area have recently opted for Optimum Lightpath's Metro

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[49] Press Release, Cox Communications, *Cox Business Services Expands Footprint to Los Angeles To Serve bandwidth-hungry businesses* (March 20, 2007), available at http://www.coxbusiness.com/pressroom/pressreleases/2007-0320.html.

[50] *Id.*

[51] *Id.*

[52] *See* About Optimum Lightpath, http://www.optimumlightpath.com/printpage7.html; *see also* Perrin, *Heavy Reading*.

[53] *See* Optimum Lightpath, http://www.optimumlightpath.com/printpage7.html.

[54] *See* Press Release, Optimum Lightpath, Westchester County Governments and Business Rely on Optimum Lightpath (June 27, 2007), available at http://www.optimumlightpath.com/Interior187-4.html.

Ethernet service because it provides "cost savings" and "enables better, faster and more valuable application deployments."[55]

35. Time Warner Cable is also competing aggressively in the special access market. Time Warner Cable is the second-largest cable provider in the United States and provides business customers with fiber-based competitive alternatives. As the company states on its website:

> We offer point-to-point, point-to-multipoint and multipoint-to-multipoint fiber optic connectivity for a high-capacity connection between multiple offices over your existing Ethernet lines – meaning you will have a dedicated fiber connection, not a shared network with costly complicated upgrades. In fact, our cost-per-Mbps is typically less than traditional telecommunications companies' solutions.[56]

36. The company's footprint extends throughout major U.S. urban and suburban areas, including Los Angeles, San Antonio, Austin, Columbus, Cincinnati and other markets in AT&T's service area. As of December 31, 2006, Time Warner Cable had 245,000 commercial high-speed data subscribers.[57] Further, Time Warner has deployed an integrated "Ethernet-to-TDM network" and provides services to "nationwide cellular telephone" providers.[58] "Time Warner Cable's solution not only reduces '2G' access costs by providing T1 circuits for

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[55] *See* Anuradha Shukla, TMCnet, *Healthcare Providers Select Optimum's Metro Ethernet Service* (Feb. 14, 2007), available at http://www.optimumlightpath.com/Interior33-6.html.

[56] *See* Time Warner Cable Business Class, http://twcbc.com/corporate/products/data/metroethernet.html.

[57] Time Warner Cable, Inc., 2006 Form 10-K, at 8 (filed Feb. 23, 2007).

[58] RAD Data Communications, Case Study, Cellular Backhaul over Metro Ethernet (Nov. 2005) available at http://www.rad.com/RADCnt/MediaServer/19960_TWC-Cell_Backhaul_Metro_Eth_CS.pdf.

backhaul, but also provides the high speed Ethernet necessary to position the cellular provider for further '3G' network expansion."[59]

37. As one example, Time Warner states: "With thousands of miles of fiber deployed in the Houston area and throughout Texas, Time Warner Cable had the vision to build a high-speed metro Ethernet network, providing commercial customers with an attractive alternative to incumbent service providers. 'We likely have the largest contiguous and completely independent fiber network in the metro space serving enterprise and carrier customers – we're completely independent of Bell facilities and span the geography area currently served by at least five separate ILECs here in the Houston metropolitan area,' said Chuck Sweeny, VP of Business Solutions of Time Warner Cable-Houston."[60]

38. Charter Communications, Inc. provides small, medium and large business customers with high-speed Internet and data networking services, as well as telephone, video and other services in 29 states. With respect to Internet services, the company's website states that it provides speeds of up to 1 Gbps in some areas via a standard Ethernet interface.[61] With respect to data networking, the company states that it can provide both point-to-point and multi-point solutions through ultra-fast Ethernet connections.[62] Industry sources have estimated that Charter has at least 200,000 commercial services customers.[63]

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[59] *Id.*; Lynette Luna, *Getting Back Backhaul Costs,* Tellabs (Winter 2005-2006), available at http://www.tellabs.com/news/reprints/backhaul_winter05-reprint.pdf.

[60] RAD Data Communications, Case Study, Cellular Backhaul over Metro Ethernet (Nov. 2005), available at http://www.rad.com/RADCnt/MediaServer/19960_TWC-Cell_Backhaul_Metro_Eth_CS.pdf.

[61] *See* Charter Business Fiber Internet, http://www.charter-business.com/Charter-Business-Fiber-Internet-Optical-Class-Services-100-Mbps-1-gigabit.aspx.

[62] *See* Charter Business Optical Ethernet, http://www.charter-business.com/Charter-Business-Optical-Ethernet-Dedicated-Bandwidth.aspx.

[63] *See Heavy Reading* at 36.

39. Comcast, the nation's largest cable provider, "supplies fiber-based services to large enterprises, K-12 schools, universities and hospitals."[64] Comcast has stated that "offering services geared to small and midsize businesses will be its top new priority of 2007 and 2008."[65] In furtherance of this goal, it has formed a multimillion-dollar venture fund for new builds to commercial customers.[66] Since Comcast provides service in 41 states, including 22 of the 25 top U.S. markets, its plans to compete for customers in the small and midsize business market pose a significant threat to the special access business of ILECs such as AT&T.

40. **The Impact Of Backhaul Services.** The recent and very substantial growth in broadband wireless and cable special access alternatives appears to be due in part to the explosive growth in demand for special access services by wireless telephone companies. Backhaul services are dedicated circuits between a wireless telephone cell site – *e.g.*, cell towers or building rooftops – and the wireless telephone carrier's switching office. Backhaul services have long been recognized as a very large market – estimates suggest that historically the backhaul market has been a $2-3 billion industry.[67] Not surprisingly, multiple alternative facilities-based providers have been drawn to the market and have offered competing backhaul services to wireless carriers. As explained in 2006 recent report by ABI Research, "[a] variety of

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[64] *Id.* at 41.

[65] *See* Peter Grant, The Wall Street Journal Online, *Cable Firms Woo Business In Fight for Telecom Turf* (Jan. 18, 2007), available at http://startup.wsj.com/runbusiness/relationships/20070118-grant.html?refresh=on; s*ee also id.* (quoting Comcast Chief Executive Brian Roberts as saying that small businesses are "'going to be our most important business customers'"); *Wallace & Bernier* (quoting the president of Comcast Business Services as saying that "the company's goal is to get 20 percent share of market over five years").

[66] *See Wallace & Bernier* (monies in Comcast's venture fund "are typically used on network enhancements and extensions needed to deliver[] high-capacity, fiber-based services to SMBs") (quoting the president of Comcast Business Services).

[67] Lynette Luna, *Getting Back Backhaul Costs,* Tellabs, at 24 (Winter 2005-2006), available at http://www.tellabs.com/news/reprints/backhaul_winter05-reprint.pdf.

backhaul technologies are used, including T1/E1 over copper, Ethernet over copper or fiber, Ethernet over cable television (CATV) networks, microwave/radio access networks, and eventually WiMAX."[68] Moreover, wireless telephone carriers themselves "are even moving toward building their own backhaul networks."[69]

41. CLECs have long been competing for backhaul services, particularly in the urban and office park areas where they have the most extensive fiber networks. Broadband wireless and cable carriers have been competing in those areas as well, but they also have been competing in the suburban and more rural areas where AT&T and traditional LECs do not have fiber facilities. Several of the broadband wireless providers that I discussed above, including Fibertower and TTMI, state that their primary focus has been on providing backhaul services at any capacity.[70] And, cable companies have been providing backhaul services for years. For example, "[a] subsidiary of Cox, the third-largest U.S. cable operator, has been providing fiber cellular backhaul for more than a decade and has deals with most of the major wireless carriers" to provide backhaul services.[71] As of 2005, backhaul revenues consisted of about "20 percent of Cox Business Service's income for the carrier services segment."[72]

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[68] ABI Research, *Wireless Backhaul: Bandwidth Explosion and Emerging Alternatives*; *Metro Ethernet, CATV, Microwave, WiMAX, and Leasing Considerations*, at 1-5 (2Q 2006).

[69] *Id.*

[70] *See, e.g.*, FiberTower Corp. – About FiberTower, http://www.fibertower.com/corp/company.shtml ("Fibertower was formed to address the weakest link in rapidly evolving wireless networks – backhaul"); TTMI, www.ttmi.info (TTMI was started to provide "cost-effective and scalable backhaul alternatives . . . for the wireless operators to transition to 3G and 4G").

[71] Lynette Luna, *Getting Back Backhaul Costs*, Tellabs, at 24 (Winter 2005-2006), available at http://www.tellabs.com/news/reprints/backhaul_winter05-reprint.pdf.

[72] *See* Karen Brown, "A Towering Opportunity?," CedMagazine.com (Sep. 1, 2005) http://www.cedmagazine.com/article.aspx?id=67126.

42. During the past few years, demand for backhaul service has begun to surge. Wireless telephone carriers have been significantly upgrading their wireless telephone networks to "3G," "3.5G," and "4G" networks. These modern wireless networks no longer carry only voice services, but also Internet, music, video and all types of other entertainment and data services. Wireless telephone subscribers have been purchasing more and more of these services. As a consequence, the amount of voice and data traffic that must be carried over backhaul facilities has increased dramatically over the past two years and continues to increase today.[73] I have seen some reports that estimate the market to grow by ten-fold in the next few years.[74]

43. There is currently intense competition for this increasing demand in the traditional downtown areas where AT&T, CLECs, and others have established fiber networks. For example, AT&T recently assessed its position in Chicago with respect to the provision of backhaul services to support a potential customer's network upgrades. That analyses showed that at least 14 CLECs already had fiber at or very near the cell sites at issue, not including fiber owned by cable operators, and thus AT&T faced stiff competition for that business.

44. There is likewise intense competition within and outside the downtown areas from cable and broadband wireless providers. As described above, these providers can claim a number of significant advantages over incumbent LECs in providing backhaul services: their networks are already deployed (or can at low cost and in a short amount of time be deployed) in these areas and the fiber, fiber-coaxial, and wireless facilities used in their networks can often offer better quality service than the copper facilities used by many incumbent LECs in these

[73] *See, e.g.*, Olga Kharif, Sprint's Secret to Cost Cutting: Wimax, BusinessWeek (Dec. 27, 2005), ("wireless backhaul is exploding as cellular service providers start running more bandwidth-thirsty data, such as video and music, over networks").

[74] Lynette Luna, *Getting Back Backhaul Costs*, Tellabs, at 24 (Winter 2005-2006), available at http://www.tellabs.com/news/reprints/backhaul_winter05-reprint.pdf.

areas.[75] AT&T, for one, has been forced by this stiff competition to implement substantial upgrades to its network so that it can continue to compete effectively against these carriers outside of the areas where AT&T already has deployed fiber. AT&T generally does not have fiber facilities to customer premises in the suburban and rural areas where cell sites are located. Rather, AT&T uses copper facilities to serve those locations. But copper facilities are generally limited to DS1 level service and there are performance issues that arise with copper that do not arise with fiber and wireless facilities. Therefore, to remain competitive as backhaul bandwidth requirements grow, AT&T is in the process of deploying fiber facilities to cell sites.

45. Cable and broadband wireless competitors already have made very significant inroads in the provision of backhaul services. For example, AT&T's research indicates that Verizon Wireless already uses competitively-supplied broadband wireless facilities at a substantial number of its cell sites. Further, **[BEGIN CONFIDENTIAL INFORMATION]**

[END CONFIDENTIAL INFORMATION]

[75] *See, e.g.*, Matt Stump, *Cable Could Haul Wireless Calls*, Multichannel News (May 15, 2006) (cable companies have "far more fiber and coaxial cable near cell towers than the telephone companies currently have" and that capacity can and is used to provide backhaul services), available at http://www.multichannel.com/article/CA6334344.html.

46. Likewise, during negotiations with AT&T for the purchase of backhaul special access services, Sprint has repeatedly pointed out to the AT&T team that Sprint has many other options to meet their backhaul needs. Sprint has discussed in detail with AT&T its ability to switch to cable and broadband wireless suppliers if AT&T does not offer terms Sprint finds acceptable. These are not hollow threats. Earlier this month, Sprint and FiberTower announced that "FiberTower had entered into an agreement with Sprint Nextel . . . to provide backhaul services [to Sprint Nextel] in seven of the wireless carrier's [Sprint Nextel's] initial WiMax launch markets."[76] **[BEGIN CONFIDENTIAL INFORMATION]**

[END CONFIDENTIAL INFORMATION] It has been reported that "Sprint recently put out a bid request to cable operators for cellular backhaul, and it got back responses from eight of the nine [cable company] MSOs."[77]

47. In addition, Sprint has announced its intention to "bypass[]" traditional special access services for its backhaul demand by deploying its own nationwide WiMAX network that will be capable of providing such backhaul services.[78] As part of this plan, Sprint recently announced a partnership with Clearwire "to build a nationwide WiMAX mobile broadband

[76] Press Release, FiberTower Announces Backhaul Agreement With Sprint Nextel for WiMax Buildout (Aug. 6, 2007), available at http://www.bbwexchange.com/pubs/2007/08/06/page1423-647177.asp.

[77] *See* Karen Brown, "A Towering Opportunity?," CedMagazine.com (Sep. 1, 2005) http://www.cedmagazine.com/article.aspx?id=67126.

[78] *See, e.g.*, Olga Kharif, Sprint's Secret to Cost Cutting: Wimax, BusinessWeek (Dec. 27, 2005), ("wireless backhaul is exploding as cellular service providers start running more bandwidth-thirsty data, such as video and music, over networks").

network, launching commercial service in the first half of 2008."[79] Moreover, the new Sprint-Clearwire WiMAX service would be available not only to Sprint/Nextel for backhaul, but to "100 million people" nationwide, thus creating yet another alternative to AT&T's traditional special access services.

48. Other wireless telephone carriers likewise have made clear that they have alternatives to AT&T's special access services when purchasing backhaul. For example, **[BEGIN CONFIDENTIAL INFORMATION]**

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49. But it is not necessary for me to rely solely on other wireless carriers and industry reports to confirm that there are myriad backhaul alternatives throughout the country. My colleagues in AT&T Mobility have confirmed that AT&T Mobility generally has multiple alternatives for backhaul suppliers at its many cell sites, and that AT&T in fact purchases thousands of DS1 and DS3 capacity backhaul facilities from broadband wireless and cable

[79] Adam Bender, *Sprint, Clearwire Team for Nationwide WiMAX Network*, Communications Daily, at 7 (July 20, 2007).

companies outside of AT&T's local service territory. In addition to the cable and broadband wireless alternatives, my AT&T Mobility colleagues report traditional wireline CLECs such as Time Warner Telecom and Level 3 (which reports that it provides services to all five of the largest wireless carriers today) also compete to serve these towers.

50. AT&T Mobility reports that it purchases more than **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** wireless backhaul DS1s and nearly **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** DS3s today from broadband wireless providers (including Fiber Tower and TTMI), cable companies (including Cox, Comcast, Time Warner and Cablevision), and traditional CLECs (including XO, Global Crossing, and Level 3). They also report that microwave backhaul arrangements, in particular, are cost effective and suitable to serve almost any tower.

51. Some of AT&T's largest special access customers, including Verizon, Sprint Nextel, T-Mobile and Level 3, are increasingly turning to services offered by intermodal providers, including Charter, Cox, Time Warner Cable, and fixed wireless providers as a substitute to AT&T special access services. Further, other substantial special access customers recently have chosen to forgo large term discounts for special access services to increase their flexibility to move substantial amounts of their demand to alternative suppliers.

52. For all of these reasons, I cannot credit the statements of Sprint, T-Mobile and other proponents of increased regulation that wireless carriers and other large special access customers lack competitive alternatives today. Moreover, as noted, due to increasing use of video, music, data and other services provided wireless telephone networks, backhaul requirements today often are increasingly at the DS3 level and that backhaul demand will

continue to increase during the next few years. As Cox reports, "the capacity they [wireless telephone carriers] are needing now . . . are T-3s or multiple T-3s . . . [and] when you are talking about that kind of capacity, the financial model has been able to prove in."[80] My team's dealings with our wireless customers confirm that wireless carriers are seeking much larger capacity facilities. One such customer, for example, in connection with its 4G upgrades is adding between 6 new DS1s and a full DS3 when using TDM facilities, or relying on Ethernet facilities with 10+ megabytes initially activated (equivalent to about 6.5 DS1s).

53. The assertion that demand is limited to a few DS1s is misleading in another way. Even if an individual wireless provider's demand is limited to a few DS1s at a particular cell site, there often are multiple wireless carriers at these cell sites, and the aggregate demand often justifies DS3 or greater capacity. This aggregate demand can be quite large even if the wireless carriers serve only voice traffic, but given consumers' demand for new, high-bandwidth wireless services, the demand for higher capacity backhaul services will only increase.

54. In any event, it is not true that there are no backhaul alternatives for DS1 circuits. This statement not only conflicts with the analyst and other industry reports that I discussed above, but more fundamentally, it directly contradicts both the public and private statements and actions of wireless companies and with AT&T's own experience as both a purchaser and seller of DS1 wireless backhaul circuits.

IV. AT&T's RESPONSE TO COMPETITIVE PRESSURES.

55. AT&T has had no choice but to respond to the intense competitive pressures for special access by improving the attractiveness of its offerings. As I explained in my 2005 declarations AT&T's (then SBC's) responses to this intense competition had been to lower

[80] *See* Karen Brown, "A Towering Opportunity?," CedMagazine.com (Sep. 1, 2005) http://www.cedmagazine.com/article.aspx?id=67126.

prices, improve service, innovate, and come up with creative ways to meet customer needs. That has continued.

56. I previously showed that in MSAs where AT&T had obtained at least some Phase II pricing flexibility – either for transport or for both transport and channel terminations – the amount that customers actually paid for AT&T's DS1 and DS3 special access services in AT&T's legacy 13-state territory fell from 2001 through 2004, both in real, inflation-adjusted terms, and in nominal terms. At my direction, AT&T has examined the trends in average revenue per unit for its DS1 and DS3 services since 2004 in MSAs where it has obtained at least some Phase II pricing flexibility, and these analyses show that the price declines have continued.[81]

57. For MSAs where AT&T has obtained at least some Phase II pricing flexibility in AT&T's legacy 13-state territory, AT&T's the average revenue per unit AT&T received for the complete DS1 special access circuits declined by **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** in real, inflation-adjusted dollars. Likewise, the average revenue per unit AT&T received for the complete DS3 special access circuits declined by **[BEGIN CONFIDENTIAL INFORMATION]**

[END CONFIDENTIAL INFORMATION] in real, inflation-adjusted dollars. Additionally, these trends do not reflect the significant rate reductions that AT&T recently implemented pursuant to its voluntary merger commitments, which have produced significant

[81] In AT&T's analyses of pricing trends from 2001-2004, it was necessary to remove the impact of mandatory "X-factor" rate reductions required by the price cap mechanism for channel terminations in areas where AT&T had received Phase II pricing flexibility for transport but not for channel terminations. No such adjustments were necessary in the present analyses because there were no such mandatory reductions from 2004 through 2007.

additional reductions in the prices customers actually pay for DS1 and DS3 services in Phase II areas.[82]

58. I would note that a recent study by the General Accountability Office ("GAO") found that prices in pricing flexibility areas (Phase I and Phase II) have decreased significantly since pricing flexibility was granted, and that "the decrease appears to be consistent with the prospect of competition that FCC predicted."[83]

59. In addition to continuing to compete aggressively on price, AT&T also has sought to improve and expand upon its current services. For example, to meet the ever increasing demand by current and future wireless backhaul customers, AT&T has increased its deployment of fiber facilities to replace existing copper facilities to serve the numerous cell site locations located outside the areas where AT&T already has deployed fiber networks. AT&T spent more than **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** in 2005 and 2006 on such fiber deployments, and AT&T has budgeted more than **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** for 2007 and 2008 to continue the program.

60. AT&T also has continued to develop and deploy custom tailored service offerings to meet the specialized needs of particular customers. To distinguish its services from the many competitive alternatives to its special access services, AT&T has devoted additional resources to provide customers even greater opportunities to purchase customized services that best meet

[82] BellSouth's 2005 comments in this proceeding analyzed tariff rates for its 9-state region for the 2001-2004 period rather than average revenue per unit inclusive of all discounts. Bellsouth has not increased any tariffed month-to-month or term DS1 or DS3 rates since 2004 (and recently reduced a number of those rate elements to implement an AT&T-BellSouth merger commitment).

[83] GAO, *FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, at 13 (Nov. 2006).

their needs. In particular, since AT&T was first granted pricing flexibility, it has entered in to more than **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** contracts with more than **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** unique customers that provide nearly **[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]** in annual savings associated with price reductions on DS1 and DS3 services. This does not include any price reductions associated with OCn level services or beneficial terms and conditions associated with DSn and OCn services, including service portability and service level commitments, which often add up to millions of dollars in extras savings for customers. These contracts are driven by the extremely competitive nature of the marketplace. AT&T's sophisticated customers desire to have agreements that are tailored to their specific business needs, and less, not more, regulation is necessary to allow AT&T to meet those demands.

VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Executed on August 8, 2007.

/s/ Parley C. Casto
Parley Casto

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ATTACHMENT
TO SUPPLEMENTAL DECLARATION OF
PARLEY C. CASTO ON BEHALF OF AT&T INC.

(FIBER MAPS)